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VOL 308

No. 15870

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

DE. VOL. 306 2

L. D. REEDER CONTRACTORS OF ARIZONA, an Arizona  
corporation,

*Appellant,*

*vs.*

HIGGINS INDUSTRIES, INC., a Louisiana corporation,

*Appellee.*

---

## BRIEF FOR APPELLANT.

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FILED  
1971  
U.S. COURT OF APPEALS  
NINTH CIRCUIT



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No. 15870

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

L. D. REEDER CONTRACTORS OF ARIZONA, an Arizona corporation,

*Appellant,*

*vs.*

HIGGINS INDUSTRIES, INC., a Louisiana corporation,

*Appellee.*

---

## BRIEF FOR APPELLANT.

---

### Jurisdictional Statement.

This is an appeal by L. D. Reeder, contractors of Arizona (hereinafter referred to as "Reeder"), plaintiff below, from an order of the United States District Court for the Southern District of California, Central Division, William M. Byrne, Judge, dismissing the action below as to the appellee-defendant, Higgins Industries, Inc. (hereinafter referred to as "Higgins"), on the ground that the said court could not acquire jurisdiction over Higgins.

The jurisdiction of the court below was founded upon Section 1332 of Title 28, United States Code. This action is one in which there is diversity of citizenship between all parties; Reeder is an Arizona corporation,

Higgins is a Louisiana corporation, and McCauley Lumber and Flooring Co., Inc., the co-defendant below, is a California corporation [R. 1, 2].

Higgins filed a motion to dismiss and to quash service; affidavits were filed; the motion was granted on November 1, 1957 [R. 85]; the formal order granting the motion and dismissing the action as to Higgins was filed November 25, 1957 [R. 87]; Reeder filed its notice of appeal on December 26, 1957 [R. 88], and the cause was docketed in this court.

The jurisdiction of this court is based upon Section 1291 of Title 28, United States Code.

### **Statement of the Case.**

Appellant, as plaintiff, filed the action below against appellee Higgins, the manufacturer, and McCauley Lumber and Flooring Co., Inc. (hereinafter referred to as "McCauley"), the wholesaler, of Higgins wooden flooring block which proved highly defective [R. 1-19].

Higgins moved to dismiss on numerous grounds, particularly that it was a foreign corporation, not amenable to service of process in California [R. 20-22]. Affidavits in support of the motion were filed on August 26, 1957 [R. 23-46], and September 5, 1947 [R. 47-49].

Appellant filed affidavits in opposition to the motion on October 11, 1957 [R. 50-68], and Higgins filed supplemental affidavits in support of the motion on October 23 and October 25, 1957 [R. 69-82, 83-84].

The matter having been submitted for decision, the court below, by minute order, ordered the motion granted "on the ground that the court does not have jurisdiction over said defendant [Higgins] because it is not doing

business in the State of California" [R. 85]. The formal order was filed, dismissing the action as to Higgins on November 25, 1957 [R. 86-87].

The *uncontradicted* facts appearing from the affidavits are:

a. Higgins has shipped into California, at a conservative estimate, one million dollars worth of its merchandise per year for the past two years; its volume of California business has been expanding since 1951 [R. 50, 61].

b. Officers of Higgins have made at least three visits to California in recent years in connection with its business [R. 70, 72, 51, 65, 67]; that the said officers did the following in furtherance of Higgins' business:

(1) Conferred and consulted with salesman of McCauley concerning sales and merchandising matters and techniques of application of Higgins' product, and consulted with employees of a flooring applicator concerning construction jobs and details of its business, and visited customers of McCauley in connection with sales [R. 51, 70, 73].

(2) Visited the office of appellant at Los Angeles in connection with shipping advices for the block which gave rise to this action, threatening to cancel unless shipment was requested immediately, and discussed a construction project in which appellant was interested [R. 65-68; 53]; the officer stated that he would personally check the progress of construction at the job involved in this suit, but neglected to do so [R. 53, 66, 70].

c. Higgins has advertised and continues to advertise on a wide scale in national and trade maga-

zines having circulation in California [R. 51-52, 60, 70]; the inquiries resulting from such advertising are sent to the distributors in California for sales follow-up as a regular course of business [R. 58, 60-61, 70]. In addition, in connection with advertising and solicitation of sales in California, Higgins:

(i) Supplies advertising mats to its distributors here for advertising in local media [R. 52, 61];

(ii) Supplies advertising brochures [R. 61];

(iii) Supplies funds to the Hardwood Flooring Council of Southern California for the promotion of hardwood products as a flooring material, as a result of which Higgins Block is exhibited by the Council at home shows and fairs in this area [R. 52, 62, 70-71, 73-75];

(iv) Higgins keeps informed as to construction projects in the offing; it keeps close contact with its distributors and urges its distributors to have their customers bid on the same [R. 62, 60];

(v) Higgins directly solicits owners and architects in order that its product may be specified for use in a particular project, as is shown by the fact that its representative contacted the owner and architect of the construction project for which the material involved in this action was ordered [R. 24]; thereafter, it checks through its distributors on progress, as it did in this instance [R. 53]; follows through on the shipping of the material involved (*supra*, b(2)), and even meets with the owners and



architect when complaint is made as was done when the material shipped to appellant proved defective [R. 54].

In addition to the above, certain *controverted* facts are of importance:

(1) The distributors, including McCauley, ordered from Higgins, as a general rule, F.O.B. Los Angeles, and have acted in accordance therewith [R. 52-53, 55, 58, 60]. Typically, orders upon Higgins are specifically marked F.O.B. point of delivery [R. 28, 29, 55], but the acknowledgements are equivocal as to passage of title [R. 31, 32, 33, 34, 56]. Higgins, on the other hand, contends that all shipments are F.O.B. Louisiana [R. 24, 35, 48, 71, 73, 84].

(2) The distributors aver that they have adjusted customer complaints on Higgins' behalf and at its expense [R. 54, 58-59, 61], which is denied in the conjunctive [R. 75].

In connection with the question of passage of title and F.O.B. provisions, it is interesting to note that the documents indicate that the minds of the parties did not meet, and therefore title did not pass until acceptance in California.

### Specification of Error.

#### I.

The court below erred in holding that appellee was not doing business in the State of California.

#### II.

The court below erred in holding that appellee was not amenable to process issued by a court sitting in California.

## ARGUMENT.

### A. Service Upon Higgins Will Not Violate Due Process.

In a decision rendered as recently as December, 1957, the United States Supreme Court has reclarified the due process requirements in connection with service upon a foreign corporation. In *McGee v. International Life Insurance Company*, 78 S. Ct. 199, 2 L. Ed. 2d 223, the court stated:

“Since *Pennoyer v. Neff*, 95 U. S. 714, 24 L. Ed. 565, this Court has held that the Due Process Clause of the Fourteenth Amendment places some limit on the power of state courts to enter binding judgments against persons not served with process within their boundaries. But just where this line of limitation falls has been the subject of prolific controversy, particularly with respect to foreign corporations. In a continuing process of evolution this Court accepted and then abandoned ‘consent,’ ‘doing business,’ and ‘presence’ as the standard for measuring the extent of state judicial power over such corporations. See *Henderson, the Position of Foreign Corporations in American Constitutional Law*, c. V. More recently in *International Shoe Co. v. State of Washington*, 326 U. S. 310, 66 S. Ct. 154, 90 L. Ed. 95, the Court decided that ‘due process requires only that in order to subject a defendant to a judgment *in personam*, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend “traditional notions of fair play and substantial justice.”’ *Id.* 326 U. S. at page 316, 66 S. Ct. at page 158.

“Looking back over this long history of litigation a trend is clearly discernible toward expanding the

permissible scope of state jurisdiction over foreign corporations and other nonresidents. In part this is attributable to the fundamental transformation of our national economy over the years. Today many commercial transactions touch two or more States and may involve parties separated by the full continent. With this increasing nationalization of commerce has come a great increase in the amount of business conducted by mail across state lines. At the same time modern transportation and communication have made it much less burdensome for a party sued to defend himself in a State where he engages in economic activity.

“[3] Turning to this case we think it apparent that the Due Process Clause did not preclude the California court from entering a judgment binding on respondent. It is sufficient for purposes of due process that the suit was based on a contract which had substantial connection with that state.”

In the *McGee* case, the foreign corporation had, by mail, offered to continue a contract of insurance which a California insured had previously entered into with another insurance company. The insured mailed his premiums from California to Texas, the home of the insurance company, and these relatively few mail transactions were all that occurred. The Supreme Court noted that the record failed to disclose that the insurance company had ever solicited or done any insurance business in California apart from the policy involved in that case. Nevertheless, it held that the requirements of due process had been met where the insurance company had been served by mail with process issuing from a California court.

Upon a reading of the *McGee* case, it is clear that appellee Higgins has more than sufficient contact with the State of California under the due process requirements, so that substituted service upon it issued by a court sitting in California would be valid.

#### **B. Under California Law, Higgins Is Amenable to Service of Process.**

The California courts have been unequivocal in asserting jurisdiction to the extent permitted by due process of law.

The California statutes authorize service of process on foreign corporations that are "doing business" in the State. The term "doing business" is a descriptive one which the courts have equated with such minimum contacts with the State "that the maintenance of the suit does not offend internal 'traditional notions of fair play and substantial justice.'" (*International Shoe Co. v. Washington*, 326 U. S. 310, 316, 66 S. Ct. 154, 90 L. Ed. 95, 161 A. L. R. 1057.)

"Doing business" within the meaning of the California statutes is synonymous with the power of the State to subject foreign corporations to local process; in other words, the limits of "doing business" are those of due process.

*Eclipse Fuel etc. Co. v. Superior Court*, 148 Cal. App. 2d 736, 738, 307 P. 2d 739.

See also:

*Gray v. Montgomery Ward, Inc.*, 155 Cal. App. 2d ....., 317 P. 2d 114;

*McClanahan v. Trans-America Ins. Co.*, 149 Cal. App. 2d 171, 172, 307 P. 2d 1023;



*Jeter v. Austin Trailer Equipment Co.*, 122 Cal. App. 2d 376, 387, 265 P. 2d 130;

*Kneeland v. Ethicon Suture Laboratories, Inc.*, 118 Cal. App. 2d 211, 218-224, 257 P. 2d 727, and cases cited;

*LeVecke v. Griesedieck Western Brewing Co.*, 233 F. 2d 772, 775;

*Kenny v. Alaska Airlines, Inc.*, 132 Fed. Supp. 838, 850.

Indeed, the California Supreme Court, in a case decided March 26, 1958, has stated that:

“Whatever limitation it [‘doing business’] imposes is equivalent to that of the due process clause.”

*Henry R. Jahn & Son v. Superior Court*, 49 A. C. 881, 884.

The *Jahn* case above cited is an excellent example of the attitude of the California courts. The dissent in that case (pp. 888-889 of 49 A. C.) accuses the court of holding that all persons residing and doing business outside California who place orders for goods in this State and arrange for the delivery of such goods, will be subject to suit in California. Apt illustrations of the California law, which govern the decision of this case, are to be found in *Duraladd Products Corp. v. Superior Court*, 134 Cal. App. 2d 226, 285 P. 2d 699, and *Gray v. Montgomery Ward, Inc.*, 155 Cal. App. 2d ....., 317 P. 2d 114 (reversing the court below).

**C. If Higgins Is Amenable to Service of Summons Issued by a California Court, It Is Amenable to Service of Process Issued by the Court Below.**

Rule 4(7) of the Federal Rules of Civil Procedure provides that summons and complaint may be served upon a foreign corporation

“in the manner prescribed by the law of the state in which the service is made for the service of summons or other like process upon any such defendant in an action brought in the court of general jurisdiction of that state.”

State law, particularly in a diversity case, governs the construction of this section. (*Kenny v. Alaska Airlines, Inc.*, 132 Fed. Supp. 838.)

**D. Conclusion.**

The law has developed and broadened in connection with modern concepts of due process in an advanced economy. It is clear that Higgins' activities in the State of California have established such contacts with this State, and with the transaction involved in this action, as to render it amenable to service of process here. Higgins, by reason of its activities here, will not be prejudiced by defending the action in California. It is respectfully submitted that the trial court erred, and must be reversed.

WISEMAN & ELMORE,

ANDREW J. WEISZ,

*Attorneys for Appellant, L. D. Reeder  
Contractors of Arizona.*

No. 15,873 ✓

United States Court of Appeals  
For the Ninth Circuit

---

E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE and HARLAN L. MCFARLAND,  
*Appellants,*

VS.

UNITED STATES OF AMERICA,

*Appellee.*

Appeal from the United States District Court for  
the Southern District of California,  
Northern Division.

Honorable Gilbert H. Jertberg, Judge.

APPELLANTS' OPENING BRIEF.

---

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FILED

JUN 18 1958

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**United States Court of Appeals  
For the Ninth Circuit**

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E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE and HARLAN L. MCFARLAND,  
*Appellants,*

VS.

UNITED STATES OF AMERICA,  
*Appellee.*

---

**Appeal from the United States District Court for  
the Southern District of California,  
Northern Division.**

**Honorable Gilbert H. Jertberg, Judge.**

**APPELLANTS' OPENING BRIEF.**

---

Come now the Appellants, E. B. Hougham, Owen Dailey, William E. Schwartz and Harlan L. McFarland, and respectfully appeal to this Court from a decision of the United States District Court, Southern District of California, Northern Division, which assessed Appellants civil penalties totaling \$8,000.00 as a result of certain alleged tricks and devices used in connection with the acquisition of War Surplus Property.

---

**PLEADINGS AND FACTS SHOWING JURISDICTION.**

This is a civil action brought by the United States as Plaintiff, under the provisions of Section 26(b) of the Surplus Property Act of 1944, 50 U.S.C.A.

§ 1635(b), repealed and reenacted as Section 209(b) of the Federal Property and Administrative Services Act of 1949, 41 U.S.C.A. § 239(b), and re-numbered 40 U.S.C.A. § 489(b), of which the District Court has jurisdiction by virtue of the provisions of Section 26(c) of the Surplus Property Act of 1944, repealed and re-enacted as Section 209(c) of the Federal Property and Administrative Services Act of 1949. (Paragraph I, Second Amended Complaint [56].)

Findings of Fact, Conclusions of Law, and Judgment in said action were signed by Judge Jertberg, Judge of the United States District Court, Southern District of California, Northern Division, on October 16, 1957, and Judgment was entered by the Clerk on October 18, 1957 [105-120].

Notice of Appeal from said Judgment was duly filed within 60 days from the entry thereof, on December 11, 1957 [122].

Bond for Costs on Appeal, and Designation of Contents of Record on Appeal were also filed, giving this Court jurisdiction of the appeal under the provisions of 28 U.S.C.A. § 1291, and 28 U.S.C.A. § 1294, since the question involved does not concern situations embracing a direct appeal to the Supreme Court as authorized by §§ 1252 and 1253 of Title 28 U.S.C.A.

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#### STATEMENT OF THE CASE.

Defendant E. B. Hougham had been a used car dealer in Bakersfield for many years, and commencing

in 1944 for several years dealt extensively in Government surplus mobile equipment.

Defendant Schwartze is the stepson of Defendant Hougham. He entered the service and was discharged in the fall of 1945 and re-entered his father's business.

Defendant Owen Dailey was a long-time friend of Defendant Hougham, having business headquarters nearby before the War, at which time he was a representative of the Firestone Tire Company. He entered the service, was voluntarily discharged, and entered Hougham's business as Sales Manager in June of 1946.

Defendant McFarland before the War was a used car dealer in his own right, entered the service, was honorably discharged, re-opened his own business, in which he was supplied merchandise for re-sale by Hougham, who consigned stock to him for that purpose.

McFarland, Schwartze and Dailey qualified under California laws as used car dealers, and acquired licenses for that purpose. Each of them applied for a Veteran's Priority Certificate for purchase of Surplus Property. Hougham supplied the money, which was used in making the purchases under the Veteran's Priority Certificates between June and December of 1946. The instant action is concerned with the propriety of these transactions.

The original Complaint was filed December 31, 1954 [3]. Briefly, it alleged that the veterans in their Priority Applications certified that the articles were to be purchased for personal use only, that the repre-

sentation was false and known to be false by both the veterans and Hougham; that in truth and in fact the veterans made no purchase, but Hougham purchased, using the Veteran's Certificates, and damages in the amount of \$2,000.00 for each act was prayed for [23].

Defendants appeared and moved to dismiss the action upon the grounds that it was barred by the Statute of Limitations. In a Memorandum Opinion Judge Jertberg held that the action was timely filed by one day [43]. Defendants answered denying the allegations of fraud, and caused interrogatories to be served upon the Government, which Interrogatories disclosed that the Veterans' Applications in respect to Owen Dailey and Harlan McFarland contained no statements that the articles were purchased for personal use only, but instead disclosed that the articles were purchased for re-sale. A motion for summary judgment, based on the Interrogatories, was made, in response to which plaintiff asked leave to amend, substituting the allegation of fraud from a misstatement in respect to personal use to an allegation that the veterans represented that they were the owners of the enterprise and had personally invested more than 50% of the capital in the enterprise, and were entitled to more than 50% of the profit in the enterprise, and that the articles were not purchased for the benefit of any other dealer, and prayed, instead of \$2,000.00 damage for each item, for double the money agreed to be paid. Objection to this amendment was made upon the ground that it also was barred by the Statute of Limitations; it was a new and independent charge of

fraud and therefore did not relate back to the filing of the original Complaint; and upon the further ground that no relief could be afforded under that prayer for the reason that the transaction in question did not involve any sum "agreed to be paid".

During this argument the Trial Judge indicated that the amendment would not be allowed in that form, but that the amendment would be allowed if the original form of relief was asked, namely, \$2,000.00 per item [43-54].

Thereupon the Government withdrew the Amended Complaint [54] and filed a Second Amended Complaint [54-72], which was allowed, and the Motion for Summary Judgment was denied.

Defendants answered the Second Amended Complaint denying the allegations of fraud, and pleaded three special defenses:

1. The action was barred by the Statute of Limitations since the original filing was not timely;

2. The cause of action set forth in the Second Amended Complaint was barred by the Statute of Limitations since it was different in form and substance from the original charge and therefore could not date back to the date of the original filing; and

3. A defense alleging that the activity of all the parties was within the objectives and policies set forth in the Surplus Property Act of 1944 and within the provisions of the regulations, and therefore not fraudulent conduct [74-88].



The case proceeded to trial without a jury upon the issues thus framed. Evidence was offered concerning the alleged false representations, all of which were contained in the Veterans' Applications to the War Assets Administration for veteran's preferences in purchasing Surplus Property, which appear in evidence as Plaintiff's Exhibits 1, 76, 94 and 97, which are set forth in the Transcript at pages 127, 206, 218 and 227, respectively. The balance of the exhibits, by and large, pertain to invoices respecting the purchase of the several items, all of which are marked "paid". Hougham advanced the funds for the payment of the same.

At the conclusion of the case the Court made Findings of Fact, Conclusions of Law, and entered Judgment, to the effect that the purchases made under each application constituted one violation, and accordingly judgment was entered against Hougham in the total sum of \$8,000.00, McFarland in the sum of \$4,000.00, and Schwartze and Dailey in the sum of \$2,000.00 each [105-119].

The Findings of Fact failed to pass upon the third special defense in any respect. It was entirely omitted.

---

#### **SPECIFICATION OF ERRORS.**

Appellant respectfully urges the following errors:

1. Error in law by the Court in failing to dismiss the original Complaint upon the grounds that the same was barred by the Statute of Limitations.

2. Error in law by the Court in failing to grant Defendants' Motion for Summary Judgment.

3. Error in law by the Court in permitting the filing of the Second Amended Complaint because:

(a) It was different in form and substance from the charge contained in the First Amended Complaint and should have been the subject of a separate action, rather than an amendment; and

(b) Being different in form and substance from the original charge, for the purposes of applying the Statute of Limitations it could not date back to the date of the filing of the original Complaint.

4. Error in law in finding action timely filed.

5. The Judgment is not supported by the Findings of Fact since they fail to find upon the Third Special Defense.

6. The evidence is insufficient to support the Findings for the reason that it contains no false or fraudulent statements or any trick or device.

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## ARGUMENT.

### POINT 1.

**THE ACTION WAS BARRED BY THE STATUTE OF LIMITATIONS  
SINCE THE ORIGINAL FILING WAS NOT TIMELY.**

The Court erred as a matter of law in failing to dismiss the original Complaint upon the grounds that the same was barred by the Statute of Limitations.

“The defense of Statute of Limitations may be raised by motion to dismiss when the times al-

leged in the complaint show that the action was not brought within the statutory period.”

*A. G. Reeves Construction Co. v. Weiss*, 119 Fed. 2d 472;

*Wright v. Bankers' Service Corp.*, So. Dist of Calif., 1941, 39 Fed. Supp. 980;

*Moore's Federal Practice*, 2d Ed., Section 12.10, page 2257.

The jurisdictional allegation of the Complaint in Paragraph I, First Cause of Action, shows that the relief sought is under the provisions of Section 26(a) of the War Surplus Act of 1944. It concerned itself with transactions occurring in 1946 (Paragraphs V, VI and VII of the First Cause of Action, Paragraph III of the Second Cause of Action, and Paragraph III of the Third Cause of Action [55-73]).

The action is in substance a civil action to enforce a civil penalty.

*U. S. v. Witherspoon*, 211 Fed. 2d 858;

*U. S. v. Strange Bros. Hide Co.*, 125 Fed. Supp. 177;

*Dugan and McNamara v. U. S.*, 127 Fed. Supp. 801;

*U. S. v. Covollo*, 136 Fed. Supp. 107;

*U. S. v. Salvatore*, 140 Fed. Supp. 470;

*U. S. v. Temple*, 127 Fed. Supp. 118;

*Erie Basin Metal Products v. U. S.*, 150 Fed. Supp. 561;

*U. S. v. Nilkey and Dawes*, 151 Fed. 2d 639 (certiorari denied);

*U. S. v. Strange Bros. Hide Co.*, 123 Fed Supp. 177.



The statutory period for maintaining an action to enforce a civil penalty ordinarily is five years. U.S.C.A. Title 28, § 2462, provides:

“§ 2462. *Time for commencing proceedings.*

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon. June 25, 1948, c. 646, 62 Stat. 974.”

Ordinarily the Statute of Limitations would bar the maintenance of this action as of December 31, 1951. However, U.S.C.A. Title 18, § 2387, provides:

“When the United States is at war the running of any statute of limitations applicable to any offense committed in connection with the disposition of any real or personal property of the United States . . . shall be suspended until three years after the termination of hostilities as proclaimed by the President or by a concurrent Resolution of Congress.”

Technically the United States was at war, although hostilities had terminated in 1946, until noon of December 31, 1946, when by Presidential Proclamation hostilities were officially terminated as of noon on that date (Proclamation 2714 12-FR-1). By virtue of the Presidential Proclamation and the suspension of the statute of limitations the running of the statute was suspended *until three years after December 31,*

1946, or until December 31, 1949. The use of the word "until" is synonymous with "up to". In this respect the following decisions are in point:

*U. S. v. Grainger*, 346 U.S. 1069 (73 S. Ct. 1069) at page 1075 states:

"When the President, December 31, 1946, proclaimed the termination of hostilities of World War II, 3 CFR, 1946 Supp. 77-78, this automatically caused the resumption of the running of statutes of limitations on December 31, 1949."

*U. S. v. Choy Kum*, 91 Fed. Supp. 769, at page 770, states:

"It is therefore said that the Suspension Act did operate in this case to toll the running of the Statute of Limitations. If that be so, since the President, by Proclamation No. 2714, dated December 31, 1946, 50 U.S.C.A. Appendix, Sec. 601 note, 12 F.R. 1, declared hostilities terminated, and by the terms of the Suspension Act the Statute of Limitations did not begin to run until December 31, 1949, then obviously this June 28, 1950, indictment is timely."

When a period of time in which an act must be done is referred to as "to", "till", or "until" a certain date, such words usually exclude the specified date. *Louisville & N. R. Co. v. Scott*, 167 So. 572, 574, 232 Ala. 284. See also 43 *Words and Phrases*, 406, 407 and 408. California decisions are in harmony with this contention.

*English v. City of Long Beach*, 250 P. 2d 298, 303, 114 C.A. 2d 311, states:

" 'Until' means up to a certain time, or place or event . . . "

The five year period of time provided by U.S.C.A. Title 28, § 2462, commenced to run December 31, 1949, and expired December 30, 1954. The time stamp on the original Complaint shows that it was filed December 31, 1954, one day too late [23].

By the same reasoning the Court was in error in permitting the filing of the Second Amended Complaint for by the time of its filing, by any process of reasoning, the five year period had run by over a year, if the pleading related to a different transaction than that in the original complaint.

If it be conceded that the original Complaint was timely filed, which we do not, nevertheless the Court should not have permitted the filing of the Amended Complaint for the further reason that its allegations were so different from and foreign to the charges of fraud contained in the original Complaint that they constituted an entirely new and separate cause of action which could not relate back to the date of the original filing. The Federal Rules of Civil Procedure, Section 15(c), are pertinent.

The difference in the matters set forth in the two Complaints are as follows:

The charge of fraud in the original Complaint was an alleged false representation that the articles were purchased for personal use. The alleged false representation contained in the Second Amended Complaint was to the effect that the veterans were the owners of more than 50% of the interest in an enterprise, and entitled to more than 50% of the profit in

the enterprise, and that the purchase for re-sale was not for the benefit of any other dealer [62, 66, 71, 72].

The writer is aware of a differing line of decisions based upon *U. S. v. Weaver*, 107 Fed. Supp. 963, and that this Court has indicated a leaning toward the Weaver decision in *U. S. v. Wilson*, 133 Fed. Supp. 882, where this Court held that an action filed on December 31, 1954, under the War Surplus Act was timely filed.

The reasons advocated in support of that opinion are different from the reasons advanced in this brief, and apparently the instant argument was not called to the attention of this Court in that hearing. Specifically, the Federal rule with reference to the computation of time would normally exclude the day on which the act was committed, in computing the statute of limitations. We do not have that problem here. We have a suspension "until" problem, and, necessarily, as soon as the suspension is lifted the statute must commence to run. By this process of reasoning December 31, 1954, was the day upon which the statute started, which would necessarily make the statute effective December 30, 1954, and not December 31.

It is to be further pointed out that under the reasoning of the Court in the *Wilson* case the cause of action alleged in the Second Amended Complaint being foreign to and different from the original allegation of fraud certainly is barred.

The foregoing argument covers Specifications of Error 1, 2, 3 and 4.

## POINT 2.

THE FINDINGS OF FACT AND CONCLUSIONS OF LAW ARE DEFECTIVE AND HENCE DO NOT SUPPORT THE JUDGMENT, FOR THE REASON THAT THEY FAIL TO FIND UPON DEFENDANTS' THIRD SPECIAL DEFENSE.

The Third Special Defense [85-88] alleges that the transactions complained of in Counts One, Two and Three of Plaintiff's Complaint were not isolated transactions, but were a part of a course of conduct carried on by Hougham and the veterans consistent with the general objectives and purposes of the Surplus Property Act of 1944.

Section 2 of the Surplus Property Act of 1944, 58 Stat., page 766, provides in part:

"The Congress hereby declares that the objectives of this Act are to facilitate and regulate the orderly disposal of surplus property so as—

(c) to facilitate the transition of enterprises from wartime to peacetime production and of individuals from wartime to peacetime employment;

(f) to afford returning veterans an opportunity to establish themselves as proprietors of agricultural, business, and professional enterprises;

(g) to encourage and foster post-war employment opportunities;

(h) to assure the sale of surplus property in such quantities and on such terms as will discourage disposal to speculators or for speculative purposes;

(l) to effect broad and equitable distribution of surplus property;



(n) to utilize normal channels of trade and commerce to the extent consistent with efficient and economic distribution and the promotion of the general objectives of this Act (without discriminating against the establishment of new enterprises);

(o) to promote production, employment of labor, and utilization of the productive capacity and the natural and agricultural resources of the country;”

Consistent with the policies contained in the Act the Third Defense alleged that Hougham conducted a wholesale and retail used car and truck sales business in which he offered to the general public, at reasonable and nonspeculative prices, commodities including war surplus materials; that he purchased the products from the veterans at prices deemed adequate by them, and that he assisted and encouraged them to establish and maintain themselves as proprietors of businesses; that he had known Dailey before the War, that he employed him after the War for a period of time in excess of six months and enabled such veteran to re-establish himself in the peacetime economy; that he had known McFarland as a wholesale and retail used car dealer for many years before the War, and that after the War he assisted him by consigning to him merchandise to operate his business and thus enable him to re-establish himself in the peacetime economy; that he was the stepfather of the defendant Schwartze and had raised him since he was 6 years old; that he had given him employment before and after the War, and that he enabled him to draw

on his business for necessary wants, and has helped and assisted him to establish himself in business; that Hougham himself, between 1944 and 1948, had been a consistent customer of the United States on his own account, and that the transactions set forth in the Complaint constituted but 10% of the gross business of Hougham in war commodities during the year 1946.

Evidence was offered in support of this pleading, and the evidence is undisputed. The record in this regard is as follows:

Testimony of Hougham: Transcript 394-420;

Testimony of Dailey: Transcript 191-200;

Testimony of McFarland: Transcript 349-362;

Testimony of Schwartze: Transcript 305-311.

The fact that the transactions complained of were not isolated transactions but were a minor part of Hougham's policy in assisting the veterans to rehabilitate themselves and in placing the commodities on the market in an equitable and orderly fashion is, to the writer, conclusive proof that there never was any contemplated, or any, fraud, trick or device undertaken or engaged in by any of these defendants.

There is no law or regulation which makes conduct of the character here outlined illegal, or which makes it amount to any fraud, trick, or device. The policy of the War Surplus Act, previously noted, is to encourage and foster post-war employment opportunities and to encourage and utilize normal channels of trade and commerce. That is the broad result of the entire transactions which are the subject of this action.

The War Surplus Act provides for dispositions to veterans as follows. Section 16 (Stat. 58, page 773) provides:

### “DISPOSITIONS TO VETERANS

SEC. 16. The Board shall prescribe regulations to effectuate the objectives of this Act to aid veterans to establish and maintain their own small business, professional, or agricultural enterprises, by affording veterans suitable preferences to the extent feasible and consistent with the policies of this Act in the acquisition of the types of surplus property useful in such enterprises.”

The type or character of the “enterprise” is in no way limited in the War Surplus Property Act, nor has it been defined in the regulations.

Pursuant to the authority extended by Section 16 of the Act Regulation 7 was issued, and on October 15, 1945, was amended, and the amendment appears in the Federal Register of October 16, 1945, at page 12849. In this Regulation the Board sought to narrow the objectives of the War Surplus Property Act by inserting restrictive definitions.

Section 8307.1 defines “own business enterprise” to be one of which more than 50% of the invested capital or net income thereof is owned by or accrues to a veteran or veterans. “Small business enterprise” includes a commercial or industrial enterprise having not more than 500 employees.

Section 8307.3 provides for veterans’ preferences and specifically includes property to be resold, with or



without fabrication, in the regular course of business. Maximum and minimum limits as to value and quantity may be established by the Board.

Section 8307.4 provides that the Board shall satisfy itself through reference to the applicant's discharge papers, or other evidence, that applicant is a veteran and that the property applied for is to be used in his own small enterprise, and shall require of the applicant a supporting statement or affidavit.

Section 8307.5 provides that surplus property may be sold or offered for sale on credit.

These regulations remained in effect until June of 1946, when the term "own business" was more restrictly defined, as follows:

"Own business or profession or agricultural enterprise of a veteran means one of which more than 50% of the invested capital thereof is beneficially and not nominally or formally owned by a veteran or veterans, or one of which more than 50% of the net income beneficially and not nominally or formally accrues to a veteran or veterans."

In other respects the new regulation is the same.

These regulations do not purport to define the word "enterprise". Neither do they purport to restrict the purchase of war surplus by veterans on borrowed capital. Nor do they restrict the class of persons to whom merchandise may be resold.

In order that any arrangement between persons may be considered a fraudulent trick or device or a

conspiracy, some wrongful or illegal objective must be the ultimate goal. The special defense in question presents this basic issue, and the judgment entered without a finding upon this defense should not be allowed to stand.

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### POINT 3.

#### **THE EVIDENCE IS INSUFFICIENT TO SUPPORT THE FINDING OF ANY FRAUDULENT TRICK, SCHEME OR DEVICE.**

In every instance in this case the government dealt with the veteran and sold to the veteran. Before dealing with the veteran on a preferential basis the government satisfied itself that the veteran was qualified to purchase. It did so by reference to the veteran's discharge papers, and a statement regarding the property desired, and other satisfactory evidence that the property applied for was to be used in his own small enterprise. It did so by supporting affidavits, all as provided by § 8307.4 of S.P.A. Regulation 7.

It is the position of appellant that the evidence fails to support the finding of any trick, scheme or device used by any of the parties because no misrepresentation was made, either as to the veterans' qualifications or as to the intended use of the property.

Although substantially the same, the supporting statements and affidavits do vary, and for this reason they will be considered separately. In each case they disclose upon their face that no inquiry was made by the disposal agency as to the specific nature or character of the "enterprise". Apparently the early policy

of the surplus agency was not to make a detailed investigation as to the nature or the extent of the enterprise, for all of the supporting affidavits relied upon by the government are blank in this respect. This policy becomes more apparent in the light of Exhibit D, [426-434] which is a form letter issued in November of 1946, after all of the transactions in question had taken place, announcing a change in the policy in this respect and requiring specific information concerning the nature, character, extent and location of the enterprise, and a letter from a Bank or Chamber of Commerce verifying the same, and also a copy of the lease or other evidence of title to the premises, if any, occupied.

The heart of the government's case seems to be that false statements were made in the application, which induced the issuance of the priority certificate. We will therefore examine the same individually.

**A. With respect to Owen Dailey.**

Plaintiff's Exhibit 1 [127] is the Application of veteran Owen Dailey. It is submitted that all of the data set forth on the face of the Exhibit is true—his name, his address, city, name of enterprise, address of enterprise, statement that the enterprise was a retailer and wholesaler of truck and automotive sales, the statement that the stock was for resale to establish and maintain business.

On the reverse side, question No. 9, "Do you desire credit in the purchase of any of the items listed?"; answer, "No". No credit was asked of the War Assets

Administration in connection with this transaction. It follows that this answer is also true. Question No. 10-A, "Working capital invested or to be invested in this enterprise by proprietors"; answer, "\$35,000.00—personal fund. By bank loan, Bank of America". A letter of credit was presented, signed by Mr. Hogan of the Bank of America. It follows that this statement is also true. Questions No. 10-B and C are estimates only. Question No. 10-C, "How much storage space will be needed?"; answer "One-half square block". "Already obtained?"; answer, "Yes". Dailey had arrangements with Hougham for the use of the storage space. Question 10-D, "If licenses for this type of business have been obtained, give date and license number"; answer, "Applied for". Question No. 11, "Branch of service"; answer, "Air Corps". "Date of release"; answer, "June 27, 1946". The answer to this question is also true. Dailey served in the Air Corps and was discharged as a Lieutenant. In answer to Question No. 12, Dailey merely signed his name. The entire body of Part 12 is stereotyped language of the Application. Question 12(A), "I qualify for the purchase of surplus property as a veteran, having served in the active military or naval service of the United States during World War II on or after September 16, 1940 and prior to its termination, and having been discharged or released therefrom under honorable conditions" is true.

Question 12(B) "That the enterprise described herein is one of which more than 50% of invested capital or net income thereof is owned by or accrues

to me” is the only part of the question having any materiality. Note particularly the language “enterprise described herein”. This language is important for the reason that it is at once apparent that no description whatever of any specific enterprise was asked for in the application. Wholesaler and retailer of truck and automotive sales—license applied for. This answer cannot be said to be false for the reason that specific information was not requested [195].

Under the laws of the State of California, one can become an automobile dealer by taking out a business license and a retail sales tax permit. The business or profession of buying merchandise for used car dealers is one commonly known to the automotive industry since its creation [192, 395, 396]. Therefore, it cannot be said that the answer to question 12(B) is in any sense false.

Question 12(C) is obviously inapplicable because question 10 fully indicates that the representation was made that the property was for resale. The answer to question 12(C), subdivision (II), is true.

Question No. 12(D), “That I am not purchasing the property herein described for the benefit of any other enterprise, dealer, broker, merchant, or other undisclosed partner or principal” is true in the sense that Dailey did receive a benefit [194]. It is obvious that whenever property is purchased for resale, persons other than the initial merchant will also benefit; otherwise, there would be no motivating factor creating the sale. The fact that Hougham also benefited is immaterial.



The final question 12(F) states "That all of the statements made in this application are true and complete to the best of my knowledge and belief". Dailey's activity under this application consisted of the following: (a) Borrowing money from Hougham; (b) using the money so borrowed to make the purchase; and (c) reselling the property to Hougham. This course of conduct, it is submitted, fails to show that at the time of the application for priority that either Hougham or Dailey had any intent to in any way defraud the Government. On the contrary, it is submitted that this course of conduct showed that both Hougham and Dailey specifically complied with all of the rules and regulations laid down in the War Surplus Property Act or in the Regulations issued thereunder.

The application was dated July 29, 1946, at which time Regulation No. 2, which is found in Federal Register of May 10, 1946, page 5125, was in effect. Section 8302.8 regulates the issuance of certificates to veterans. Subdivision (a), in part, states:

"War Assets Administration will satisfy itself through reference to the applicant's discharge papers or to other satisfactory evidence that the Applicant is a veteran and that the property applied for is for his own personal use or to enable him to establish or maintain his own small business, professional, or agricultural enterprise, and shall require of the Applicant a supporting statement or affidavit."

The supporting statement of Dailey is Plaintiff's Exhibit 1 [127]. Had further information been desired,

a suitable request could have been made at the time of the application, which was apparently not done. Apparently at this time it was not the Government's policy to require further information than that requested, because it appears that at a later date in November all veteran dealers' priority certificates were recalled and further and more specific information required as a condition to their re-issuance. (See Defendants' Exhibit D [426-434].)

There is nothing in the Regulation which prohibits surplus purchases with borrowed money. To the contrary, the Act and the Regulation specifically provide for sales on credit. Section 8302.8, Subdivision (d), provides:

“Surplus property may be offered for sale to veterans on credit on terms and conditions established by the disposal agencies.”

Neither does the Regulation contain any limitation in respect to persons entitled to purchase property from veterans after the veterans have acquired the same from the Government. Any such purported limitations would be contrary to the objectives of the Surplus Property Act and void. *People v. Finn Twins*, 127 Fed. Supp. 158, affirmed on appeal by Circuit Court (239 Fed. 2d 679); *School District v. United States*, 229 Fed. 2d 681; *Hagger v. Helvering*, 308 U.S. 389, 60 Sup. Ct. 337; *Sanford v. Commissioner*, 308 U.S. 39, 84 Law Ed. 20; *Barnett v. Chicago Portrait*, 285 U.S. 1; *Draagoon v. United States*, 144 Fed. Supp. 188.

If it is proper to purchase surplus property on the credit of the government or a Bank, why is it not proper to purchase surplus property with funds borrowed from a friend? If it is proper to purchase surplus property for resale to anyone, why is it not proper to purchase property for resale to a used car dealer? If there is nothing irregular in purchasing surplus property with borrowed capital, and if there is nothing irregular in selling surplus property purchased with borrowed capital to a car dealer, why should the transaction become "tainted" when the lender and the dealer happen to be the same person? Two rights do not make a wrong.

This is the foundation upon which the government's case is constructed. It is submitted that such an interpretation of the regulations is contrary to fundamental rules of law. The case of *John A. Roebling's Sons Co. v. Industrial Accident Commission*, 36 Cal. App. 10, at page 14 states:

"Where various theoretical conclusions may be drawn from the state of facts established, each being equally plausible, . . . then it may not be said that the evidence is sufficient to sustain the case of him upon whom the burden of proof rests."

And on the petition for hearing:

"The justices opposed to granting the application for a hearing in this court are of the opinion that the opinion of the District Court of Appeal means that in this case there was no substantial evidence reasonably warranting an inference favorable to the claim . . . and that any finding to



the contrary is necessarily based on mere surmise, speculation, or conjecture . . .”

*Coffman v. California State Board of Architectural Examiners*, 130 Cal. App. 343, 19 Pac. (2d) 1002 at page 1004 states:

“The act does not attempt to define what constitutes dishonest practice, for the very good reason, perhaps, that such dishonest practice assumes such a wide range and variety of acts and misconduct that a definition could not embrace its many forms, *but for that reason the acts complained of should be found with such definiteness and certainty that the vice of the acts complained of might be apparent to all.*”

2 Cal. Jur. 2d 248, Section 145, states:

“The findings, decision, and orders of administrative agencies must be supported by evidence of sufficient probative force to establish the fairness of their action. While disciplinary proceedings involving the revocation or suspension of licenses are not criminal in nature, *all intendments are in favor of the accused and the charges against him must be proved by clear and convincing evidence* before the right to engage in the licensed profession or business may be taken away. *An administrative determination must be supported by something more than suspicion or conjecture, speculative, theoretical conclusions surmise, fanciful or fictitious pretense, inherent improbability, or uncorroborated hearsay or rumor.*”

The interpretation of the regulations contended for by the government are contrary to the plain language and policy of the War Surplus Act and for this reason they should not be allowed to stand.

It follows that the evidence in respect to Owen Dailey wholly fails to support a finding of fraud, trick or device in connection with the acquisition and/or disposition of War Surplus property and for this reason the judgment should be reversed.

**B. With respect to Harlan McFarland.**

McFarland made two applications for surplus property; one on March 20, 1946, and the second on July 2, 1946. The latter application will be discussed first, since it was applied for at a time when War Assets Administration Regulation 2 was in effect. The evidence shows that Harlan McFarland had been a used car dealer before the war, entered the service, and was honorably discharged in late 1945; that he attempted to re-establish his business but was unable to secure merchandise due to O.P.A. ceilings; that he entered into a consignment arrangement with Hougham, who stocked his used car lot by placing a flooring price upon each vehicle, which was repriced by McFarland and sold to the general public. McFarland retained the spread between the cost and the sale price, maintained his own lot, paid for his own help, lights, etc. McFarland also acted as a buying dealer, borrowed money from Hougham, purchased surplus under a priority application, sold the same to Hougham at a \$10.00 per vehicle profit, and resold approximately one-half of his purchases to the general public after the same had been consigned to his lot by Hougham [349-352; 358-362].

His priority application is Plaintiff's Exhibit 94 [218]. The information on the front page is, without

exception, true. He maintained his business at 1200 East 19th Street, Bakersfield, California, and it was operating at the time. Photographs of the business are in evidence, Defendants' Exhibit C [353-355].

On page 2, section No. 18 of the application, McFarland signed the certificate, the language of which is entirely the language of the Government. He certified "I am or will be the sole proprietor of the enterprise described herein". The evidence bears out this contention and this assertion in every respect. The words "That no persons other than veterans will have any proprietary interest in the enterprise in excess of 50% of either the capital invested in the enterprise or of the gross profits or income thereof" are likewise true, for McFarland had and maintained his own individual enterprise. He further certified "I am not procuring the property listed in this application for the purpose of resale". This is obviously directly inconsistent with the information supplied on the face of the application to the effect that he was an automobile dealer, Dealer's license No. 3116-B/ED18417. See *Lee v. U.S.*, 167 Fed. 2d 137; *American Publishing Company v. Landwehr*, 80 N.Y.Supp. 2d 193.

Under no stretch of the imagination could any person be lead to believe that an automobile and truck dealer would buy 25 trucks for purposes other than resale. There is no evidence of any trick, device, scheme or arrangement of any kind that is not entirely legal in respect to this application.

McFarland's first application, Plaintiff's Exhibit 97, [227] is dated March 20, 1946. At that time,

Surplus Property Regulation No. 7 was in effect. It appears in Federal Register of October 16, 1945, commencing at page 12849. It is substantially the same as the previous regulation, although in some respects less complete. For instance, Section 8307.1(b) defines:

“‘Own’ business or professional or agricultural enterprise means one of which more than 50% of the invested capital or net income thereof is owned by or accrues to a veteran or veterans.”

It specifically authorizes veterans to purchase property for resale under priority. Section 8307.3, in part, provides:

“Such preference shall extend to property necessary to establish and maintain their own small business, agricultural and professional enterprises, and, within reasonable limits commensurate with the enterprise established or to be established and in commercial lots appropriate to the level of trade, to one initial stock of property to be resold with or without processing or fabrication in the regular course of business.”

Section 8307.4 provides:

“Smaller War Plants Corporation shall satisfy itself through reference to the applicant’s discharge papers or to other satisfactory evidence that the applicant is a veteran and that the property applied for is to be used in his own small enterprise, and shall require of the applicant a supporting statement or affidavit.”

Section 8307.5 provides:

“Surplus property may be offered for sale on credit on terms and conditions established by the disposal agencies.”



Nowhere in this regulation is there a requirement that the veteran refrain from purchasing on borrowed money. Nowhere in the regulation is there any restriction as to persons to whom the veteran may resell the property purchased under the priority.

Section No. 2 of this application, in reference to mailing address, contains "114 Market Street, San Francisco", which is lined out and over the same "1200 East 19th St., Bakersfield, Calif." Section No. 5, address of enterprise, "2401 E. 14th St., Oakland, Alameda, Calif." shows on its face an inconsistency because it is contrary to section No. 2, mailing address. McFarland at this late date does not remember the reason for the inconsistency, but never had a business at that address, and always had his business at 1200 East 19th Street, Bakersfield, California. [348]

Conceding this answer to be a misstatement, it does not follow that a trick or device or scheme was perpetrated upon the Government by the mistake. There was no evidence offered to the effect that veterans in any particular area were entitled to any particular preference, and the Regulation itself applies throughout the continental United States. See Section 8307.2. Mr. Karl F. Koenig, called as a witness for the Plaintiff, was chief of the sales branch of the Federal Supply Service Utilization for Profit, Division of the General Services Administration (Reporter's Transcript, [234]) and was with the War Assets Administration as surplus property disposal officer in 1946 [335]. He testified that there was no territorial distinction in reference to veterans [265].

The other statements upon the face of the application are, without exception, true. The enterprise had been established before the war; it was at the time of the application not being operated. He intended to operate "as soon as stock can be purchased". His experience was given as "Auto sales & service business since 1933". On the reverse side, under section 18, he signed the stock certificate formulated by the Government to the effect that "he was a veteran", which was true; "honorably discharged", which was true; "that he was the sole proprietor of his business", which was true; "that no persons other than veterans will have a proprietary interest in the business, singly or together, directly or indirectly, in excess of 50% of the capital invested in the enterprise", which was true; or "of gross profit or income therefrom", which was true.

The certificate further stated "I am not procuring the property listed in this application for the purpose of resale, and that said property is to be used in and as part of the enterprise described herein". It is obvious that this is an inconsistency and not a false statement, for on the face of the application he stated that his enterprise was a truck sales and service business, and that he intended to use the stock applied for in the business. As stated in the *Lee* case, previously cited, there is no inconsistency such as could be made the basis of a trick or device.

The money used for the purchases made under the priority application was money loaned to him by Hougham. The sales were made to Hougham after

the purchases had been completed from the Government. For the reasons stated in the argument in respect to Dailey, there is no concealment of any kind, and the things done were in strict compliance with the provisions of the War Surplus Property Act and the Regulations Nos. 7 and 2.

**C. With respect to William E. Schwartz.**

Schwartz was the stepson of the defendant Hougham, and had resided in his home since the age of six. He entered the service and was honorably discharged in the fall of 1945, after which time he made an extensive buying tour of war surplus disposing agencies with his father. [305] Upon this tour, it became apparent that there was a demand for a trucking rental and service business created by purchasers of war surplus material who had difficulty in securing transportation for the same away from the surplus yards. [306] He decided to commence such a business, intending to operate it himself, to secure the funds from his father, and to repay his father out of the business. [307] The father supplied the funds which eventually purchased trucks and trailers applied for by Schwartz under a veteran's application for surplus property, which appears in evidence as Plaintiff's Exhibit No. 76. [206]

This application gives "525 Jones Street, San Francisco", as a mailing address; the nature of the enterprise "Schwartz Truck Rental"; address of enterprise "525 Jones Street, San Francisco"; description of enterprise "Truck rental"; individual proprietorship.

Question No. 7, "Is the enterprise already established", has a garbled answer. Apparently the word "No" is written after the word and upon the word "Yes", because the following question, "If 'yes', are you now operating it?", is answered "no". Question, "How and when do you plan to start your operations if you are starting a new enterprise or buying into an existing enterprise?"; answer, "I plan to start with the surplus units I obtain".

Question No. 9, "What experience, training, and/or education have you had which you believe assures the success of this enterprise?"; answer, "Have worked for a truck dealer as a salesman".

Application was made for fourteen trucks and fifteen low-bed trailers, heavy duty. Under question 18, the usual Government certificate was signed by Schwartz.

Immediately after the acquisition of the material, and while transporting the same away from the surplus center, Schwartz was stopped by a California Highway Patrolman, who branded the trailers as too wide for use upon California highways. The trucks were found to be too uneconomical for civilian use. The project was abandoned and the equipment purchased was disposed of through Baker's Motor Market by Hougham [308].

It is submitted that there is nothing in this application which in any way amounts to a trick or device of any character. The San Francisco address is unimportant because there was no territorial limitation



in effect, according to the testimony of Karl Koenig, and because of the provisions of Surplus Property Board Regulation No. 7 previously noted. This Regulation was in effect at the time of this application. The state of mind of the applicant at the time of the signing of the application is the important feature, insofar as Schwartz is concerned. There is no reason or evidence in the record by which any doubt can be cast upon his veracity, insofar as his intention to enter into the trucking business is concerned. The fact that he abandoned the project does not make the acquisition of the property fraudulent. This identical situation existed in the *Lee* case previously cited.

In the Complaint, Schwartz is charged with making purchases in June, July, August and September of 1946, covering items which do not appear upon the surplus application, Exhibit 76. Apparently they were purchased under the provisions of Section 8307.7 of Regulation 7, as purchases without exercising preferential rights. At any rate, there is no proof of any alleged fraudulent representation in reference to their acquisition.

**D. With respect to E. B. Hougham.**

It is submitted that the record is totally devoid of any irregularity of activity upon Hougham's part.

There is no prohibition in the War Surplus Act against loaning or advancing money to veterans. There is no prohibition in the War Surplus Act or in the Regulations restricting any veteran from dealing with a used car dealer after acquiring property from

the Government under a preferential application. Hougham took no part in the signing of any application and was not present and had no knowledge of any statement made by any applicant in connection with the application. Knowing that certain properties were set aside for veteran dealers, he made no attempt to deal with the Government direct, but dealt in the manner prescribed in the Act and Regulations, which gave the preferential benefit to the veteran with whom he dealt [406-418]. He is in every respect a bona fide purchaser of every article which he acquired through the veterans.

This is not a case such as *U.S. v. Comstock Extension Mining Company*, 214 F. 2d 400, where parties knowingly entered into a combination to defeat restrictive regulations which limited certain items to veterans for their personal use only. There the veteran certified that the article was for his personal use, he went to the disposal center with the other parties who advanced the money, acquired title to the jeep, turned it over to them immediately, and they practically drove it off the lot. There unquestionably was a deliberate false representation in that veteran's application which was known by all parties.

In this case, the representation in the case of McFarland and Dailey was that they were automobile dealers, and they were, in fact, qualified under the laws of California to engage in that business. They did nothing except what they purported to do in their application. In the case of Schwartze, he bonafidely

intended to enter the truck rental business and this intention was frustrated.

This is simply a case where the surplus administrators satisfied themselves that the veterans were qualified to acquire surplus property for resale. Had they wished more specific information, they should have inquired for it.

Both Hougham and the veterans are entitled to the view that the transactions were bona fide, since there is no law or regulation prohibiting or restricting a transaction of the character here involved.

Section 25 of the War Surplus Act provides:

#### “TITLE OF PURCHASER

SEC. 25. A deed, bill of sale, lease, or other instrument executed by or on behalf of any Government agency purporting to transfer title or any other interest in property under this Act shall be conclusive evidence of compliance with the provisions of this Act insofar as title or other interest of any bona fide purchasers for value, or lessees, as the case may be, is concerned.”

The statutes and regulations under which this action is brought are penal in character and as such should be construed strictly against the State and in favor of these defendants. They should not be enlarged by implication or intendment beyond the fair meaning of the language used, and should not include offenses and persons other than those clearly described and provided for. 82 C.J.S. 924, § 389 and § 390.

**CONCLUSION.**

It is submitted that the instant action was filed untimely, that the special defense of the broad policy of the War Surplus Act was ignored, that the statutes under which the action was brought have been construed against rather than in favor of the defendants, and that the evidence, fairly taken and properly construed, fails to show any fraudulent trick, scheme or device used in connection with the acquisition of any surplus property by any of these defendants.

For each of these reasons a reversal should be in order.

Dated, Bakersfield, California,  
June 16, 1958.

Respectfully submitted,

CONRON, HEARD & JAMES,

By CALVIN H. CONRON, JR.,

*Attorneys for Appellants.*

**(Appendix Follows.)**

## Appendix

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No. 15873

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**In the United States Court of Appeals  
for the Ninth Circuit**

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UNITED STATES OF AMERICA, APPELLANT

*v.*

E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE AND HARLAN L. MCFARLAND, APPELLEES

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E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE AND HARLAN L. MCFARLAND,  
APPELLANTS

*v.*

UNITED STATES OF AMERICA, APPELLEE

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF CALIFORNIA, NORTHERN  
DIVISION

---

**BRIEF FOR THE UNITED STATES AS APPELLANT AND  
APPENDIX**

---

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*United States Attorney,*

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FILED

JUN 21 1958



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# In the United States Court of Appeals for the Ninth Circuit

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No. 15873

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v.

UNITED STATES OF AMERICA, APPELLEE

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF CALIFORNIA, NORTHERN  
DIVISION

---

## BRIEF FOR THE UNITED STATES AS APPELLANT AND APPENDIX

This suit was filed by the United States to recover civil damages from defendants, who had fraudulently obtained certain Government surplus property in violation of Section 26 of the Surplus Property Act of 1944, 58 Stat. 765, 50 U. S. C. App. (1946 ed.) 1611 *et seq.*, *infra*, pp. 6-7. On October 16, 1957, the United States District Court for the Southern District of California awarded judgment in favor of the United

States for \$8,000.00 (R. 119-120). The Government here appeals from that judgment on the ground that it is entitled to a damage award in the amount of \$159,025.32.<sup>1</sup>

The jurisdiction of the district court rested on 28 U. S. C. 1345 and Section 26 (c) of the Surplus Property Act of 1944, 58 Stat. 780, 50 U. S. C. App. (1946 ed.) 1635 (c). The Government's notice of appeal was filed on September 13, 1957 (R. 121). The jurisdiction of this Court is invoked under 28 U. S. C. 1291.

#### STATEMENT OF THE CASE

The Government filed its initial complaint on December 31, 1954 to recover civil damages for violation of the Surplus Property Act of 1944, *infra*, pp. 6-7 (R. 3-23). This complaint contained five causes of action. Each of these causes of action alleged that E. B. Hougham, individually and doing business as Baker's Motor Market, conspired with a particular named veteran to violate the Act. The substance of the charge was that Hougham used each of the veterans as a front man to purchase for him, with the use of the veteran's priority certificate, surplus-property vehicles to which Hougham was not otherwise entitled. The veterans in the first three causes of action were defendants Owen Dailey, William E. Schwartz and Harlan L. McFarland, respectively. The fourth and

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<sup>1</sup> Defendants have also filed an appeal contending that the Government's action is barred by a statute of limitations and that there is insufficient evidence to support the district court's finding that they were guilty of fraud (R. 450). We will meet these contentions in a separate answering brief. Our present brief is, of course, limited to the issue presented by our appeal.



fifth causes of action, involving other veterans, were subsequently dropped.

Paragraph VIII of the first cause of action alleges that the defendants named therein (Hougham and Dailey) are liable to the United States in the sum of \$2,000.00 for each violation of the statute plus double the amount of actual damages sustained by the Government (R. 9-10). This allegation is incorporated by reference in Paragraph I of the other two relevant causes of action (R. 10, 13). This measure of damages is expressly provided for by Section 26 (b) (1) of the Surplus Property Act, *infra*, p. 6. Based on its belief that the purchase of each vehicle was a separate violation of the Act, the Government sought damages totalling \$300,000.00 from these three veterans and Mr. Hougham in view of their fraudulent purchase of 150 vehicles (R. 22-23).

Thereafter the Government moved for leave to file a first amended complaint, pursuant to Rule 15 (a) of the Federal Rules of Civil Procedure (R. 23-24). Attached to this motion was the proposed first amended complaint (R. 25-43). The proposed first amended complaint was substantially identical with the Government's initial complaint, except that counts four and five of the initial complaint were dropped and the measure of damages which the Government sought was altered. Paragraph VIII of count one of the proposed first amended complaint alleged damages—as provided for in Section 26 (b) (2) of the Act—in the amount of twice the consideration paid to the United States for the fraudulently obtained prop-

erty,<sup>2</sup> rather than the measure of damages provided by Section 26 (b) (1) of the Act (\$2,000.00 plus double damages for each violation of the Act). This allegation in count one of the proposed first amended complaint was incorporated by reference in counts two and three by Paragraph I of those counts (R. 32, 36). This complaint alleged that the defendants paid \$79,512.66 for their fraudulently obtained property. Accordingly, under Section 26 (b) (2), of the Act, the Government was entitled to \$159,025.32, substantially less than the \$300,000.00 it sought in its original complaint. Nevertheless, the court ruled that the theory of damages could not be amended because, the court reasoned, the Government had made an irrevocable election by filing its initial complaint (R. 116).<sup>3</sup> Accordingly, the Government withdrew the proposed first amended complaint and filed a motion for leave to file a second amended complaint (R. 48). This complaint, subsequently filed, sought damages in the amount of \$2,000.00 for each violation of the Act, proceeding under 26 (b) (1) of the Act, as did the initial complaint.

The defendants answered this second amended com-

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<sup>2</sup> The prayer for damages at the end of the proposed first amended complaint repeated the assertion of this measure of damages.

<sup>3</sup> In its pre-trial order, the court noted the Government's contention that it was entitled to double the consideration paid for the fraudulently obtained property (R. 101). After stating its ruling that an irrevocable election of alternative statutory measures of damage had been made by the filing of the initial complaint, the court noted that "[p]laintiff respectfully calls this to the attention of the Court so that the point may be preserved for purposes of appeal" (R. 101).

plaint (R. 74-88), and after a full trial on the merits, the district court, per Jertberg, J., ruled that "these [three veterans] were largely messenger boys in acquiring the surplus vehicles that Mr. Hougham felt that he could use in his business" (R. 443). "As far as any enterprise of these three men it was purely synthetic" (R. 443). In its formal findings of fact, the court found that each of the three veterans used their veteran's priority certificate to obtain surplus property, not for their own businesses, but for Mr. Hougham (R. 105-119). In computing the damages to which the Government was entitled, the court proceeded under 26 (b) (1) of the Act (\$2,000.00 for each violation plus double the amount of actual damages sustained). The court rejected the Government's contention that the purchase of each vehicle constituted a separate violation of the Act (R. 444-447). Instead it ruled that each fraudulent application for a veteran's priority certificate constituted a violation of the Act (R. 446-447). On this basis, the Government had proved only four violations since only four applications were involved.<sup>4</sup> Accordingly, the Government's recovery was limited to \$8,000.00, despite the fact that defendants' purchases amounted to \$79,-

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<sup>4</sup>Owen Dailey and William E. Schwartze each filed a single application and made their purchases pursuant to a single priority certificate issued in reliance on these applications (R. 119-120). Harlan L. McFarland filed two applications on the basis of which he received two priority certificates (R. 120). Accordingly, judgment against Dailey and Schwartze was entered in the amount of \$2,000.00 each, and judgment against McFarland was entered in the amount of \$4,000.00 (R. 120). E. B. Hougham was made jointly and severally liable with each of the veterans (R. 119-120).

512.66 (R. 107, 110, 112-113, 55-73). From this limitation of liability based on election of remedies doctrine, the Government appeals.

#### STATUTE AND RULES INVOLVED

1. Section 26 of the Surplus Property Act of 1944, 58 Stat. 765, 50 U. S. C. App. (1946 ed.) 1635,<sup>5</sup> now appearing at 40 U. S. C. 489, provides in pertinent part as follows:

(b) Every person who shall use or engage in or cause to be used or engaged in any fraudulent trick, scheme, or device, for the purpose of securing or obtaining, or aiding to secure or obtain, for any person any payment, property, or other benefits from the United States or any Government agency in connection with the disposition of property under this Act; or who enters into an agreement, combination, or conspiracy to do any of the foregoing—

(1) shall pay to the United States the sum of \$2,000 for each such act, and double the amount of any damage which the United States may have sustained by reason thereof, together with the costs of suit; or

(2) shall, if the United States shall so elect, pay to the United States, as liquidated damages, a sum equal to twice the consideration agreed to be given by such person to the United States or any Government agency; or

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<sup>5</sup> The Surplus Property Act of 1944 was repealed by the Act of June 30, 1949, 63 Stat. 399. However, 1 U. S. C. 109 provides that a repealed act shall be treated as remaining in force with respect to any penalty, forfeiture, or liability incurred prior to the repeal. See *United States v. Weaver*, 107 F. Supp. 963 (D. C. N. D. Ala.), reversed on other grounds, 207 F. 2d 79 (C. A. 5).



(3) shall, if the United States shall so elect, restore to the United States the property thus secured and obtained and the United States shall retain as liquidated damages any consideration given to the United States or any Government agency for such property.

\* \* \* \* \*

(d) The civil remedies provided in this section shall be in addition to all other criminal penalties and civil remedies provided by law.

2. Rule 2 of the Federal Rules of Civil Procedure provides as follows:

There shall be one form of action to be known as "civil action".

3. Rule 8 (e) of the Federal Rules of Civil Procedure provides as follows:

(1) Each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required.

(2) A party may set forth two or more statements of a claim or defense alternately or hypothetically, either in one count or defense or in separate counts or defenses. When two or more statements are made in the alternative and one of them if made independently would be sufficient, the pleading is not made insufficient by the insufficiency of one or more of the alternative statements. A party may also state as many separate claims or defenses as he has regardless of consistency and whether based on legal or on equitable grounds or on both. All statements shall be made subject to the obligations set forth in Rule 11.

4. Rule 15 of the Federal Rules of Civil Procedure provides in pertinent part as follows:

(a) *Amendments*.—A party may amend his pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, he may so amend it at any time within 20 days after it is served. Otherwise a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires. A party shall plead in response to an amended pleading within the time remaining for response to the original pleading or within 10 days after service of the amended pleading, whichever period may be the longer, unless the court otherwise orders.

(b) *Amendments to conform to the evidence*.—When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the object-



ing party fails to satisfy the court that the admission of such evidence would prejudice him in maintaining his action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.

(c) *Relation back of amendments.*—Whenever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading.

#### SPECIFICATION OF ERRORS

1. The District Court erred in holding that the United States irrevocably elected its choice of statutory remedies for fraud by filing its original complaint.

2. The District Court erred in refusing to allow the Government to amend its initial complaint with respect to damages.

#### ARGUMENT

**The District Court erred in holding that the Government irrevocably elected its choice of statutory remedies for fraud by filing its initial complaint and that it was thereafter foreclosed from amending its complaint with respect to damages**

##### Introduction and summary

The Surplus Property Act of 1944, 58 Stat. 765, 50 U. S. C. App. (1946 ed.), 1611 *et seq.* was enacted to provide for the disposal of large quantities of material owned by the Government at the conclusion of World War II. See *Rex Trailer Co., Inc. v.*

*United States*, 350 U. S. 148. Section 26 of that Act, which is involved here, provides the Government with civil remedies for fraudulent acts in connection with the disposal of this property.<sup>6</sup> That section it is appropriate to note, is of continuing importance, since its pertinent provisions have been reenacted *in haec verba* in the Federal Property and Administrative Services Act of 1949, 63 Stat. 378, 392, 40 U. S. C. 471, 489, which governs the present disposal of almost all government property, including military.

To provide, in the language of the Committee Report, for the "honest administration of the Act" the United States is given, in addition to criminal sanctions, three civil remedies against those who defraud their Government in connection with the disposal of surplus property. The civil remedies are in the nature of liquidated damages (see *Rex Trailer Co., Inc. v. United States*, 350 U. S. 148, 150-152; *United States ex rel. Marcus v. Hess*, 317 U. S. 537, 548-549), and are available against "every person who shall use or engage in \* \* \* any fraudulent trick, scheme, or device, for the purpose of securing or obtaining \* \* \* for any person any payment, property, or other benefits from the United States or any Government agency in connection with the disposition of property under this Act; or who enters into an agreement, combination, or conspiracy to do any of the foregoing". Section 26 (b) of the Act, 50 U. S. C. App. (1946 ed.) 1635.

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<sup>6</sup> See preceding footnote, p. 6.

<sup>7</sup> S. Rept. 1057, 78th Cong., 2d Sess., p. 14.

Section 26 (b) provides that those who thus defraud their Government:

(1) shall pay to the United States the sum of \$2,000 for each such act, and double the amount of any damage which the United States may have sustained by reason thereof, together with the costs of suit; or

(2) shall, if the United States shall so elect, pay to the United States, as liquidated damages, a sum equal to twice the consideration agreed to be given by such person to the United States or any Government agency; or

(3) shall, if the United States shall so elect, restore to the United States the property thus secured and obtained and the United States shall retain as liquidated damages any consideration given to the United States or any Government agency for such property.

In addition, Section 26 (d) specifically preserves any other civil remedies which may otherwise be available to the Government.

The court below has held that by alleging damages in its initial complaint in the amount of \$2,000 for each violation of the Act, plus double the amount of actual damages, the Government closed the door on the other remedies which the statute provides. To reach this result the district court relied on an overly technical and outmoded application of the doctrine of election of remedies. In so doing, the court permitted those who, by its own finding, have defrauded their Government to escape the full measure of damages stipulated by the Act. If this holding is law, it means that those who have cheated their Government can

avoid the full effect of the statute because of a pleader's error.

That the doctrine of election of remedies is inapplicable to the situation in the case at bar is clear from the holding in *Bernstein v. United States*, Nos. 5704 and 5705, decided by the Court of Appeals for the Tenth Circuit on May 23, 1958. In an almost identical surplus property fraud case, that Court held that the application of the election doctrine to the mere filing of a complaint contravened both the letter and the spirit of the Federal Rules of Civil Procedure. Accordingly, an amendment to the prayer for damages was held to be valid against the affirmative defense of election of remedies.

Moreover, the doctrine of election of remedies has no application to statutory measures of damage because these statutory remedies are not "inconsistent", as that term is used in election of remedies cases. The statutory remedies, unknown to the common law, are simply alternatives available to the Government, and the same factual allegations and proof will support any of the remedies. For this reason too, the doctrine has no application to the case at bar.

To apply the election doctrine so as to foreclose an amendment to a complaint in these circumstances clearly runs counter to the oft-quoted admonition of the Supreme Court in *Friederichsen v. Renard*, 247 U. S. 207, 213:

At best this doctrine of election of remedies is a harsh, and now largely obsolete rule, the scope of which should not be extended \* \* \*



***A. Under the Federal Rules of Civil Procedure the mere filing of a complaint does not amount to an irrevocable election of remedies***

Less than a month ago, the Court of Appeals for the Tenth Circuit—in a case on all fours with the one here—flatly ruled that the doctrine of election of remedies is inapplicable to the mere filing of a complaint by the Government seeking recovery under one of the alternative measures of damages authorized by Section 26 (b) of the Surplus Property Act, *Bernstein v. United States*, Nos. 5704 and 5705 (C. A. 10). (This opinion is reproduced in an appendix to this brief for the Court's convenience.) That ruling, we submit, was plainly correct and should be followed here. In the *Bernstein* case, as in the case at bar, the Government designated a particular statutory remedy in its initial complaint. Later attempts to amend the prayer for damages in the initial complaint proved ineffective because of the district court's ruling that the doctrine of election of remedies limited the Government to the theory of the initial complaint.<sup>8</sup> On appeal, the Tenth Circuit reversed:

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<sup>8</sup> In the *Bernstein* case, the district court allowed amendments to the complaint, but sustained the defendant's affirmative defense of election of remedies; whereas in the instant case the district court refused to allow an amendment seeking damages under a different section of the statute. The distinction is without a difference. In both cases the district court relied on the doctrine of election of remedies to restrict the Government to a theory of damages under that section of the statute designated in its initial complaint.

If anything, the instant case is even stronger than the *Bernstein* case because in the instant case the damages prayed for in the initial complaint were substantially more (\$300,000.00) than the damages sought in the disallowed amended complaint (\$79,512.66), while in *Bernstein*, the reverse was true.

Moreover, the district court in the instant case limited the

Whatever may be said for the common law doctrine of election of remedies before the advent of the Federal Rules of Civil Procedure, we are certain that there is no room for its application under applicable rules of procedure, according to which every pleading is a simple, concise statement of the operative facts on which relief can be granted on any sustainable legal theory "regardless of consistency, and whether based on legal or equitable grounds, or both"; Rule 8 (e) (1) (2) F. R. C. P., and, where the prayer or demand for relief is no part of the claim and the dimensions of the lawsuit are measured by what is proven. \* \* \*

When the complaint is judged in the context of the philosophy of these modern procedural concepts, we are convinced that the election of remedies is inapplicable here. \* \* \*

The basis for the decision is clearly sound. As the Supreme Court recently reiterated, "The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits." *Conley v. Gibson*, 355 U. S. 41, 48. The outmoded "theory of the pleadings"

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Government not to the construction of Section 26 (b) (1) relied on by the Government in its initial complaint—under which the purchase of each vehicle was a separate violation and under which the Government was thus entitled to \$300,000—but to the court's own interpretation of that section whereby the Government was limited to only four forfeitures on the theory that only each fraudulent application was a violation of the Act.



doctrine has been discarded by the Federal Rules. *Conley v. Gibson*, *supra*; II Moore, *Federal Practice*, Sec. 8.14. "The modern philosophy concerning pleadings is that they do little more than indicate generally the type of litigation that is involved". *S. E. C. v. Timetrust, Inc.*, 28 F. Supp. 34, 41 (D. C. N. D. Calif.). "Under the prior federal practice, the pre-trial functions of notice-giving, issue-formulation and fact revelation were performed primarily and inadequately by the pleadings. \* \* \* The new rules, however, restrict the pleadings to the task of general notice-giving," *Hickman v. Taylor*, 329 U. S. 495, 500-501.

Under these Rules where the filing of a complaint is simply notice generally of the type of suit involved it is patently erroneous to hold that an irrevocable election of remedies is made by the filing of a complaint without more. Under the notice theory, the complaint simply serves notice on the defendants that the Government is seeking civil damages for violation of the Surplus Property Act in connection with the transactions described in the complaint. To hold otherwise is to re-introduce the theory of the pleadings doctrine through the back door.

As Judge Yankwich said in an early case, "Under the liberal rules of the reformed procedure, a plaintiff is entitled to recover, not on the basis of his allegations of damages or of his theory of damages, but on the basis of the facts as to damages shown in the record". *Nester v. Western Union Telegraph Co.*, 25 F. Supp. 478, 481 (D. C. S. D. Calif.). Thus, under the Federal Rules "even the demand for judg-

ment loses its restrictive nature when the parties are at issue, for particular legal theories of counsel yield to the court's duty to grant the relief to which the prevailing party is entitled". *Gins v. Mauser Plumbing Supply Co., Inc.*, 148 F. 2d 974, 976 (C. A. 2). See also *Western Machinery Co. v. Consolidated Uranium Mines*, 247 F. 2d 685 (C. A. 10) and Rule 54 (c) F. R. C. P.

Moreover, Rule 15 (a) F. R. C. P. allows an amendment to a pleading as a matter of right before a responsive pleading is served; and thereafter amendments may be made with leave of court, the rule specifically providing that "leave shall be freely given when justice so requires". Rule 15 (a) F. R. C. P. Rule 15 (b) allows amendments to the pleading to conform to the proof even after all evidence is in, and "even after judgment".

The effect of the Federal Rules of Civil Procedure on the doctrine of the election of remedies has often been noted: "[It] is certainly the theory of the Rules," says Moore, "that, unless *prior to the action* a party has made some choice or taken some step which under applicable *substantive* law would be regarded as an election, he may prosecute his claim or defenses without being put to an election." II Moore, *Federal Practice*, Sec. 2.06 [3], p. 362. [Emphasis supplied.] See also *North American Graphite Corp. v. Allan*, 184 F. 2d 387 (C. A. D. C.); *Senter v. B. F. Goodrich Co.*, 127 F. Supp. 705 (D. C. D. Colo.); 4 *Encyclopedia of Federal Procedure* (3d Ed.) 14.198; I Baron and Holtzoff, *Federal Practice and Procedure*, § 282, p. 534, n. 90. Finally, in *Smith v. Pin-*

ner, 68 Ariz. 115, 201 P. 2d 741, the Supreme Court of Arizona applying its state rules, which are identical with the Federal Rules in all respects here material, rejected the same contention that the defendants are making in the instant case based on the doctrine of election of remedies. The Arizona court stated:

\* \* \* Prior to the adoption of our new rules of civil procedure this contention would constitute a correct statement of the law, but the adoption of the Rule 8 (e), which is Section 21-408 of the Arizona Code Annotated 1939, authorized pleadings which contained inconsistent statements of the pleader's claim. Under such circumstances the theory of election of remedies in this instance is not applicable. \* \* \* (68 Ariz. at 119-120, 201 P. 2d at 743).

\* \* \* \* \*

Moreover, even before the promulgation of the Federal Rules, the Supreme Court, in an *a priori* case, ruled that the filing of a complaint does not amount to such an election of remedies as to foreclose an amendment changing the theory of damages, *Friedrichsen v. Renard*, 247 U. S. 207. In that case a suit in equity was filed by the purchaser of land to rescind for fraud. A master, to whom the case was referred, found that the suitor was not entitled to the equitable relief he sought because he had cut some timber on the land, thus making a return to the status quo impossible. The court thereupon ordered the case transferred to the law docket and allowed an

amendment of the prayer after the statute of limitations had run, so that the suitor now sought, instead of rescission, damages. The defendant argued that "in disaffirming the contract by his suit in equity, the petitioner elected to pursue one of two inconsistent remedies open to him, until the period of the statute of limitations had expired, and that he therefore cannot escape that bar when afterwards, by amendment of his pleadings, he seeks to affirm the contract and recover damages", 247 U. S. at 211. This is precisely the argument presented by the defendants here, except that in the instant case the defendants' position is considerably weaker in that no statute of limitations is applicable to this suit. In the *Renard* case, the Supreme Court ruled that the amendment to the prayer for damages was proper, and stated:

At best this doctrine of election of remedies is a harsh, and now largely obsolete rule, the scope of which should not be extended \* \* \* (247 U. S. at 213).

In reaching this conclusion the court noted the effect of the liberal amendment procedures provided for by the then applicable rules.

In view of the New Equity Rules of 1912, especially Rule 22, and of the Act of Congress of March 3, 1915, 38 Stat. 956, it cannot be said that the power of courts of equity to amend pleadings, or to permit them to be amended, to accomplish the ends of justice, has been curtailed since the *Hardin Case* was decided in 1884. (247 U. S. at 212).



In the case referred to in the quotation, *Hardin v. Boyd*, 113 U. S. 756, the court allowed an amendment to a bill in equity to rescind a conveyance for fraud so that it would include an alternative prayer for the purchase money and a lien on the land to the extent of the purchase money. In the *Hardin* case, the motion to amend was not even made until all the evidence was in. Despite this fact, the Supreme Court affirmed the allowance of the amendment, stating:

It may be said, generally, that in passing upon applications to amend, the ends of justice should never be sacrificed to mere form, or by too rigid an adherence to technical rules of practice (113 U. S. at 761).

Opposed to this array of authority, we have found no federal case in which the filing of a complaint has been held to foreclose the amendment procedure on the ground that the suitor had irrevocably elected his remedy by filing his complaint. It is thus clear both on authority and reason that the mere filing of a complaint does not prevent the Government from amending the complaint to alter the measure of damages it seeks.

***B. The election doctrine is inapplicable to statutory remedies because they are not "inconsistent" as that term is used in election cases***

Aside from the effect of the Federal Rules on the common law doctrine of election of remedies, the doctrine is inapplicable here because the remedies are not inconsistent as that term is used in election cases. The remedies here are simply alternative remedies, not inconsistent, because the application of each de-

pend solely on the identical state of facts, the violation of the statute. Only when the remedies are "inconsistent" is the plaintiff traditionally put to an election.

The so-called "inconsistency of remedies" is not in reality an inconsistency between the remedies themselves, but must be taken to mean that a certain state of facts relied on as the basis of one remedy is inconsistent with, and repugnant to, another state of facts relied on as the basis of another remedy. See e. g., *United States Fidelity and Guaranty Co. v. First National Bank*, 172 F. 2d 258, 262, n. 3 (C. A. 5); *Georgia Power Co. v. Fountain*, 207 Ga. 361, 366, 61 S. E. 2d 454, 457, certiorari denied, 340 U. S. 934; *Boeing Airplane Co. v. Aeronautical Industrial District*, 91 F. Supp. 596, 612 (D. C. W. D. Wash.), aff'd., 188 F. 2d 356 (C. A. 9); *Senter v. B. F. Goodrich Co.*, 127 F. Supp. 705, 707-8 (D. C. D. Colo.); "Election of Remedies", 18 Am. Jur. 127, 135. Thus it has been held that "when a certain state of facts under the law entitles a party to alternative remedies, both founded upon the identical state of facts, these remedies are not considered inconsistent remedies, though they may not be able to 'stand together'; the enforcement of the one remedy being a satisfaction of the party's claim." *McMahan v. McMahan*, 122 S. C. 336, 342, 115 S. E. 293, 295.

This of course is exactly the situation in the case at bar. So long as a violation of the Surplus Property Act is proved, the Government is entitled to any of the alternative three remedies producing the highest award. But the application of any of these statutory



remedies, unknown to the common law, depends on the identical state of facts. The remedies are alternative, not inconsistent; they neither affirm nor disaffirm the transaction. The Government seeks recovery solely on the basis of the violation of a fraud statute; the remedies are predicated on this fraud alone. There is thus no room for the application of the election doctrine to alternative statutory remedies based on identical facts, for these remedies are not, in terms of the doctrine, inconsistent. Consequently the doctrine does not and was not intended to have any application to actions instituted pursuant to the Surplus Property Act.

#### CONCLUSION

For the reasons stated, it is respectfully submitted that the judgment below should be reversed with respect to the Government's appeal, with directions to enter judgment against the defendants under Section 26 (b) (2) of the Surplus Property Act.

GEORGE COCHRAN DOUB,  
*Assistant Attorney General,*  
 LAUGHLIN E. WATERS,  
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 HERSHEL SHANKS,

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*Department of Justice, Washington 25, D. C.*



## APPENDIX

United States Court of Appeals, Tenth Circuit

MAY TERM—1958

Number 5704

ABE BERNSTEIN; MOREY BERNSTEIN; SAM BERNSTEIN;  
BERNSTEIN BROS. PIPE AND MACHINERY COMPANY, A  
CORPORATION; MAURICE LEVY; ROSE LEVY; ALBERT  
BENSIK; AND MODERN SPECIALTY DISTRIBUTORS, A  
PARTNERSHIP, APPELLANTS

*v.*

UNITED STATES OF AMERICA, APPELLEE

Number 5705

UNITED STATES OF AMERICA, CROSS-APPELLANT

*v.*

ABE BERNSTEIN; MOREY BERNSTEIN; SAM BERNSTEIN;  
BERNSTEIN BROS. PIPE AND MACHINERY COMPANY, A  
CORPORATION; MAURICE LEVY; ROSE LEVY; ALBERT  
BENSIK; AND MODERN SPECIALTY DISTRIBUTORS, A  
PARTNERSHIP, CROSS-APPELLEES

APPEAL AND CROSS-APPEAL FROM THE UNITED STATES  
DISTRICT COURT FOR THE DISTRICT OF COLORADO

Morrison Shaforth and Charles Rosenbaum for  
appellants and cross-appellees. Hershel Shanks  
(Joseph D. Guilfoyle, Donald E. Kelley and Morton  
Hollander were with him on brief) for cross-ap-  
pellant and appellee.

Before BRATTON, *Chief Judge* and HUXMAN and MURRAH, *Circuit Judges*.

MURRAH, *Circuit Judge*.

This is an appeal from a civil judgment in a suit by the United States against the appellants and others under the fraud provisions of the Surplus Property Act of 1944, 58 Stat. 765, 780, now Section 209 (b) Federal Property and Administration Act of 1949, 63 Stat. 377, 392.

On the critical dates of the complaint, Section 26 (b) of the 1944 Act provided in substance that every person who engages in any fraudulent scheme or device for the purpose of securing or obtaining, any surplus property of the United States, or who agrees or conspires to do so, shall be liable to the United States for enumerated elective remedies. Jurisdiction of suits under the Act was vested in the United States. Section 26 (c).

The trial court's judgment is based upon an ultimate finding to the effect that in the fall of 1946, the appellants entered into an agreement or conspiracy to defraud the United States in connection with the sale of surplus property of the United States in San Antonio, Texas, by arranging to have war veteran Bensik, an employee of Bernstein Brothers, Inc., apply for a veteran's priority certificate for the purchase of the property in question, ostensibly in his own behalf, for use in his own business, but actually in behalf of and for the benefit of Bernstein Brothers, the purpose and object being to enable the Company to gain possession and control of priority surplus property which, for lack of such priority, it would not be entitled or eligible to obtain.

The underlying facts are that appellant, Bensik, a war veteran doing business as the Modern Specialty Distributors in Pueblo, Colorado, was distributing

grave monuments and other odds and ends, including some reconditioned Stewart-Warner airplane heaters. Appellant, Bernstein Brothers Pipe and Machinery Company, is a large established retail and wholesale dealer in both new and used pipe and machinery in Pueblo. The individual appellants, Bernsteins, are officers and principal owners of the corporation. Appellant, Levy, is a brother-in-law of the corporation president, and General Sales Manager of the company. Bensik started working for the corporation as a salesman in February 1946 for \$250.00 per month, but continued to conduct his own small business on the side. On October 20, 1946, Bensik made an application and was certified by the War Assets Administration in Denver, Colorado, for a veteran's priority to purchase \$3,000.00 worth of gasoline engine compressors. In his application, he represented that no person other than himself had any proprietary interest in his enterprise in excess of fifty percent of the invested capital or of the gross profits or income thereof; that he was not a broker, and would not broker the surplus property; and was not purchasing the property for the use and benefit of any other enterprise, dealer, broker, merchant or other undisclosed partner or principal.

About the time of his application and certification for the engine compressors, the War Assets Administration offered 928 Herman Nelson airplane heaters and 3341 Stewart-Warner heaters for sale as surplus property in San Antonio, Texas. The property was offered concurrently to all priority groups, including World War veterans, and all levels of trade—all priority groups to bid without price, awards to be made to priority groups at the lowest acceptable price. With notice of this offering, Bensik returned to the War Assets Administration office in Denver on No-



vember 18 or 19, and asked to be recertified for \$25,000.00 worth of surplus property, including \$20,000.00 worth of "heating and ventilating equipment and machinery—Texas". At the same time, he submitted a letter from a Pueblo bank stating that he was a legitimate dealer and wholesaler of equipment and supplies, and had on deposit with the bank at that time \$25,000.00. The bank credit was arranged by appellant Levy, who gave the bank his personal check for \$25,000.00 in exchange for a cashier's check for that amount "payable to ourselves" for Bensik's account. Previously, and on October 31, Bernstein Brothers issued its check to Levy for \$21,532.00 in payment of his annual salary, less taxes, and Levy apparently financed the transaction with this check and another from Morey Bernstein in the sum of \$7,500.00, which was never honored. In connection with his application for the recertification, Bensik submitted a grossly exaggerated financial statement in which he listed \$28,000.00 in cash, evidently including the \$25,000.00 bank credit represented by the cashier's check. He also certified in connection with this priority application that he had made necessary arrangements to become "an established dealer, jobber or distributor of the kind who customarily take into their possession and have full control for the purpose of reselling property of the kind covered by this order"; that he was not a broker and would not use the property ordered to operate as such; and that he would not engage in "drop sale" in his disposal of the property.

On the basis of these latter representations, Bensik's application was reviewed and he was recertified for the purchase of \$20,000.00 worth of the heating and ventilating equipment as a specialty distributor. The original application was stamped "initial stock



for resale''. On the next day after the last certification, the \$25,000.00 cashier's check was redeposited to Levy's account. He thereupon issued a check to his wife for \$20,000.00 and she secured a cashier's check for \$20,000.00 "payable to the order of ourselves December 13, 1946''. This check was left with the bank for Mr. Bensik. The check to Levy's wife (Bernstein's sister) was a loan to finance the Bensik transaction.

On December 10, Bensik was awarded 600 Herman Nelson heaters at a unit cost of \$33.26, or a total sum of \$19,956.00. The awards were made on the basis of Bernstein Brothers' nonpriority highest best bid on the whole offering of both the Herman Nelson and Stewart-Warner heaters. Bensik did not go to San Antonio and never examined the heaters before bid or purchase, but appellant, Sam Bernstein, was in San Antonio to bid on the heaters without priority. While there, Bernstein, in a chance conversation with a stranger, later discovered to be a bidding competitor, unwittingly stated that he was working through Mr. Bensik, and inquired whether the stranger "would be interested in purchasing for companies."

After the award of the heaters to Bensik, Sam Bernstein arranged to have them shipped to Bernstein Brothers warehouse in Pueblo and paid the freight. On December 13, 1946, three days after the award of the heaters to Bensik, and before arrival at the Bernstein Brothers warehouse, Rose Levy and Bensik entered into an agreement, by direction of her husband, Maurice Levy, under which Rose Levy agreed to loan Bensik \$20,000.00, to be used for the purchase of the 600 heaters. It was agreed that the merchandise would be shipped to Pueblo and stored in the Bernstein warehouse; that

Bensik would proceed to sell the heaters, and after payment of all charges, the proceeds would be applied toward the repayment of the \$20,000.00 loan, plus interest. The remainder of the proceeds were to be divided between the parties, forty-five percent to Levy and fifty-five percent to Bensik. It was agreed that all of the proceeds from the sale would be placed in an account known as the Levy-Bensik special account, and that all checks written on such account would be signed by both parties. It was to be distinctly understood that the parties did not intend by their agreement to constitute a partnership, but that the moneys provided to be paid to Levy over and above the loan should merely constitute "interest and return on the said loan." Bensik executed his note to Rose Levy for the \$20,000.00 loan. The \$20,000.00 cashier's check was thereupon deposited in a new account for the Modern Specialty Distributors, and a check was drawn on this account by Bensik to the Treasurer of the United States in payment of the heaters previously awarded to him.

On December 24, and before arrival of the merchandise in Pueblo, Bensik formally agreed in writing to sell Bernstein Brothers 510 of the heaters at \$35.00 each f. o. b. San Antonio, payment to be made as delivery to the Bernstein warehouse was completed. The 510 heaters were duly transferred to Bernstein Brothers for a profit of \$1.74 per unit to Levy and Bensik, netting Bensik \$488.70. Bernstein Brothers finally sold the 510 heaters for a gross price of \$141,154.24, or an average price of \$276.00 each. Bensik advertised and eventually sold the remaining 90 heaters for a total profit of \$24,000.00, which he divided with Rose Levy in accordance with their contract.

During this time, Bensik purchased from Bernstein Brothers the smaller and less expensive Stewart-

Warner heaters for \$125.00 each and resold them for \$195.00, and the government emphasizes this disparity in purchase and sale of heaters as evidence of the lack of the bona fides of the whole transaction.

The property in question was awarded to Bensik on the basis of his veteran's priority, for which Bernstein Brothers was ineligible. And, it would undoubtedly be contrary to the spirit and purpose of the Surplus Property Act and actionably wrong, to use Bensik's priority to obtain the property on behalf and for the benefit of Bernstein Brothers. *Rex Trailer Co. v. United States*, 350 U. S. 148; *Daniel v. United States*, 234 F. 2d 102. Indeed, the gist of the government's claim is that the parties conspired to use Bensik's priority to secure or obtain property for Bernstein Brothers. But appellants earnestly insist that Bensik purchased the property in his own right for his own account; that the subsequent sale of a major portion of it to Bernstein Brothers was not prohibited by any applicable regulation, and was moreover with the knowledge and tacit consent of the War Assets Administration. In other words, the sale was "real and not a sham", hence without fraud or actionable wrongdoing.

No one seems to contend that any applicable regulation forbade the resale of the property to whomsoever Bensik chose. Nor are there any inhibitions against veterans having nonveteran partners in small business enterprises, so long as the veterans are not mere fronts. See *Lee v. United States*, 167 F. 2d 137. Nor do we think the representations made for the first certification pertinent to the later certification for the property in question. The first priority was for the veteran's own use, not for resale. The second priority was for property intended for resale and the latter representation superseded the former



and is relevant to the challenged transaction. Therein Bensik certified in effect that he was an established dealer, jobber or distributor, purchasing for resale; that he was not a broker and would not use the property ordered to operate as such—in other words, that he was not acting as the agent of an undisclosed principal who was ineligible to purchase the property on a veteran's priority.

On December 10 (the date of the award to Bensik) Morey Bernstein wrote to the representative of the War Assets Administration in Denver who had certified Bensik's priority, confirming a telephone conversation on November 20 (the day after certification), wherein Bernstein had inquired whether, in the event Bensik's bid was successful, it would be satisfactory for Bensik, the sole owner of Modern Specialty Distributors and a salesman for Bernstein Brothers, to sell Bernstein Brothers a substantial portion of the material purchased, so long as he distributed the remainder among several different buyers. The letter indicated that the representative of the War Assets Administration had replied that in his opinion, there was no objection to this procedure. Three days later, however, the Chief of the Veteran's Division of the War Assets Administration in Denver, replying to Bernstein's letter, stated that "while Bensik is the man who should make the decision regarding the customers he serves", for his protection, and in view of the connection between Bensik and Bernstein Brothers, Bensik should contact the Office of the Regional Counsel for the War Assets Administration. On December 18, Bensik wrote to the Regional Counsel, stating that he was the owner and operator of the Modern Specialty Distributors and a salesman for Bernstein Brothers; that he had sold portable heaters before the San An-

tonio purchase; that he was definitely not acting as a broker; that "Bernstein Brothers merely want to purchase a lot of these heaters from me, but they are extremely careful and wanted to advise you of their action." The Regional Counsel replied in part that "in your case, this office considers it definitely inadvisable for you to sell any part of the material which you purchased to a firm by which you are employed, inasmuch as the transaction would lead to the conclusion that you might merely be acting as agent of that firm in the purchase of surplus property."

While this correspondence did generally advise the War Assets Administration that Bensik planned to sell a major portion of the property to Bernstein Brothers, it also served to advise the appellants that in the circumstances, the transaction smacked of an illegal agency. The first letter of December 10, reflecting the telephone conversation of November 20, left no doubt that from the very inception of the transaction, Bernstein Brothers intended to acquire the major portion of the heaters to be awarded to Bensik under his veteran's priority. In any event, there was nothing in the correspondence to indicate that the appellants relied upon statements contained in the government letters, or that they were deceived or misled in any way. In determining in the last analysis whether Bensik purchased the heaters for his own account as an established dealer for resale, or as a mere broker or agent for Bernstein Brothers, it is significant to note that the gain he realized from the 510 heaters is more like a broker's commission than an established dealer's legitimate profit.

When the evidence is considered in its entirety, we are certainly unable to say that the inferences which the trial court drew from the established facts were

unwarranted, and that its judgment thereon is clearly erroneous.

Invoking the rule in *Jencks v. United States*, 353 U. S. 657, appellants complain of the refusal of the trial court to require the government to produce for purposes of impeachment on cross-examination, a report of a government witness made and submitted to the War Assets Administration in connection with his investigation of this case. Witness Poyen did make a report of his investigation in February 1947, and he did refresh his memory from it while testifying as a government witness.

Simple justice and fundamental fairness becoming the sovereign require it to make available to the accused any matter from which its witnesses testify, if such testimony is material and the credibility of the witness in respect thereto is attacked, and proper foundation is laid for impeachment. See *Jencks v. United States*, *supra*; *Communist Party of United States v. Subversive Activities Control Board* (CA D. C. 1/9/58) — F. 2d —. The operative facts in this case occurred in 1946; the case was filed in 1951, and tried in 1956. On pre-trial the court denied appellant's motion for the production of the Poyen report under Rule 34 F. R. C. P. Certainly if the report was relevant and not privileged for security reasons, see *United States v. Reynolds*, 345 U. S. 1; or as "an attorney's mental impression, conclusions, opinions or legal theories", it was a proper subject for production and inspection under Rule 34 for good cause. See *Hickman v. Taylor*, 329 U. S. 495. And, it was undoubtedly subject to production and inspection during trial for impeachment purposes if there was any material testimony to impeach.

On direct examination, witness Poyen testified that he went to Pueblo in 1947 to investigate the case for



the War Assets Administration; that he contacted appellant Bensik at Bernstein Brothers Pipe and Machinery Company; that Bensik told him he had been working for Bernstein Brothers about six months for about \$300.00 per month; that Bensik took him to his home in Pueblo and showed him a mock-up of a circular he proposed to distribute throughout the country for the promotion and sale of the heaters. When asked if he recalled the substance of the mock-up for the circular, he answered, "well, having refreshed my memory from my report, I can report on it reasonably accurately." Then he proceeded to state the kind of heaters and the price at which they were to be sold, and other details of the proposed circular. The witness went on to state that in answer to questions, Bensik told him he had sold 510 of the heaters to Bernstein Brothers for \$35.00 each under the written contract of December 24, 1946. He further testified that Bensik told him the 90 heaters he proposed to sell were in Bernstein Brothers warehouse; that he had paid for all 600 of the heaters with a check for the full amount on the Modern Specialty Distributors. When asked how he had been financed, he refused to answer or give any information. The witness went on to state that almost immediately after filing his report with the Enforcement Division of the War Assets Administration in Denver, he entered the private practice of law, and that soon thereafter Morey Bernstein called him on the telephone to inquire whether he might be available to act as his attorney in a case, and that he told him he would be unable to do so. When the witness was unable to recall the details of the conversation, government counsel claimed complete surprise, but abandoned further interrogation on that point. He then related a conversation with appellant Levy in the wit-

ness's law office. Levy wanted to know the status of the case, and whether in his investigation he had gotten information he needed. The witness advised him that he had completed his investigation, was in the private practice of law, and could not discuss it with him; and they then discussed his retention as an attorney for Bernstein Brothers, Mr. Levy saying that the fees were immaterial.

At this point, counsel for appellants made demand on the government to produce the report made by the witness to the government. The government objected on the grounds that no proper foundation had been laid, the government having abandoned "that line of questioning \* \* \*." The court took the view that since counsel's objection to the witness's testimony based on the report had in the main been sustained, its production was not required unless cross-examination developed something that would entitle the appellants to see some part of the report. Counsel for appellants sought production of the report for impeachment purposes, and on the further ground that "throughout the examination the attorney for the government was constantly referring to this report."

The decisive fact is that witness Poyen testified to nothing from his report, either on direct or cross-examination, that is disputed now or at the time of trial. His only disputed testimony concerned conversations with Bernstein and Levy, held after he had submitted his report and left the service of the government. In short, there was nothing in his testimony to impeach by reference to the report. We therefore hold that fundamental fairness exemplified in *Jencks* does not require a reversal of the court's ruling.

Finally, appellants complain of the refusal of the court to permit appellant Levy to testify concerning

advice of counsel on the validity of the Bensik-Levy contract, under which Levy's wife advanced the funds to purchase the heaters. Advice of counsel is invoked to show lack of fraudulent intent. Levy was permitted to testify that his attorney drew the Bensik-Levy contract on information given him by the parties, but the court refused to permit him to testify concerning advice of counsel on the validity of the contract.

Generally, where, as here, fraud is an essential element of the charge, the accused may testify not only that he had no such intent, but he may buttress his statement by proof of conversations with other persons tending to support his statement. *Frank v. United States*, 220 F. 2d 559; *Haigler v. United States*, 172 F. 2d 986; *Miller v. United States*, 120 F. 2d 968. The gravamen of this charge is, however, not the validity of the Bensik-Levy contract. Instead, it is an arrangement between the appellants, whereby Bensik used his veteran's priority to obtain government surplus property in behalf of and for the use and benefit of Bernstein Brothers. There was no testimony or offer of proof indicating that advice of counsel was sought or given concerning the legality of this particular arrangement. And see *McDonald v. United States*, 246 F. 2d 727.

#### CROSS-APPEAL

The United States has appealed from that part of the judgment which puts it to an election of statutory remedies under Section 26 (b) of the Surplus Property Act of 1944, *supra*. Section 26 (b) provided that any person who shall engage in a scheme or device condemned in this Section "(1) shall pay to the United States the sum of \$2,000 for each such act, and double the amount of any damage which



the United States may have sustained by reason thereof, together with the cost of suit; or (2) shall, if the United States shall so elect, pay to the United States, as liquidated damages, a sum equal to twice the consideration agreed to be given by the United States or any Federal agency to such person or by such person to the United States or any Federal agency, as the case may be; or (3) shall, if the United States shall so elect, restore to the United States the money or property thus secured and obtained and the United States shall retain as liquidated damages any property, money, or other consideration given to the United States or any Federal agency for such money or property, as the case may be." The remedies thus provided are "in addition to all other criminal penalty and civil remedies provided by law." Section 26 (d).

In its original complaint, filed in February 1950, the government prayed for twice the consideration paid the United States for the surplus property, in the amount of \$39,912.00. In October, the government moved to amend, alleging that since the filing of the original complaint, it had come to the attention of the Department of Justice that the Bernsteins had made a large profit from the sale of the heaters alleged to have been fraudulently acquired by them; and that if the charges in the complaint were established, the Bernsteins would be liable to the government for the profits, thus greatly enhancing the amount to be recovered. In January 1952, an amended complaint was filed, in which the government sought restoration of the merchandise, or damages in the amount of the proceeds of the sale by the Bernsteins. And, it also reiterated its prayer for twice the consideration paid the government for the merchandise.

After answer to this complaint was filed, and pursuant to leave granted, the government again amended its complaint in April 1954 to pray in the alternative for (1) restoration of the property or the cash proceeds of its sale; (2) twice the consideration paid for the merchandise as originally demanded; and (3) or \$2,000 plus twice the amount of damages which the government might have sustained in the sale.

In their answer to the last amended complaint, the appellants moved to compel the government to elect its remedy in accordance with the original complaint, viz, twice the amount of the consideration paid the government for the merchandise. This motion was denied in March 1955, but the government was ordered to elect which of the three remedies it would seek. The government thereupon elected to demand restoration of the property or the proceeds of the sale thereof, less the amount paid the government, together with interest and costs. In an amended answer to the last amended complaint and election filed February 27, 1956, appellants pleaded as a defense the election made in the government's original complaint to demand twice the consideration paid for the merchandise.

The trial court assumed the availability of equitable restitution as an additional remedy "provided by law" under Section 26 (d). And, we have no doubt of it. The court took the view, however, that the government was bound by its original election to affirm the transaction and seek twice the amount of the purchase price of the merchandise. In so doing, it applied the common law doctrine of election of remedies, according to which an aggrieved party with a cognizant choice of two or more remedies for inconsistent rights growing out of the same transaction



must elect one of the remedies to the exclusion of the others. See 18 Am. Jur. Election of Remedies, § 3, p. 129; *Kuhl v. Hayes*, 212 F. 2d 37. "The doctrine of election of remedies is not a rule of substantive law. It is a rule of procedure or judicial administration. It is technical \* \* \*." See Brandeis dissenting in *United States v. Oregon Lumber Co.*, 260 U. S. 290, 304. It has been consistently criticized as harsh and not a favorite of equity. See *Oil Well Supply Co. v. First National Bank of Winfield*, 106 F. 2d 399. It has been applied to suits by the government with caution. *Goldstein v. United States*, 277 F. 2d 1.

The trial court recognized that ordinarily an original complaint will not constitute an election precluding a prayer for an inconsistent remedy in an amendment. But the court was nevertheless constrained to enforce the election made in the original complaint because, if the doctrine is "not applicable here, it would be hard to conceive of an instance where it would be" for, said the court, the government "positively stated in its original complaint that it was making and asserting its election," and in so doing, it affirmed the sale to Bensik by seeking liquidated damages as provided in the statute, and having done so, it should not thereafter be permitted to elect to disaffirm the transaction by seeking restitution. The court observed that the government was undoubtedly apprised of the profits the Bernsteins were making on the resale of the heaters, the evidence showing that prior to the filing of the complaint, they had sold sixty-nine percent of the heaters and parts for \$96,677.28, and that between the first complaint and the first amendment in 1951, they had sold \$10,935.00 more, and thereafter \$33,541.96; that the last heater was sold in March, and the final election was made

in the following April. From this the trial court reasoned that the election the government made in April 1955 could very well have been made upon the filing of the first complaint in 1950. The court finally concluded that the appellants "should not be penalized for failing to guess which mode of relief the government would finally adopt, and during the entire period curtail their business and sell slow-moving merchandise accordingly." The court found ample evidence of damage to the appellants upon which the doctrine of election of remedies should rest.

Whatever may be said for the common law doctrine of election of remedies before the advent of the Federal Rules of Civil Procedure, we are certain that there is no room for its application under applicable rules of procedure, according to which every pleading is a simple, concise statement of the operative facts on which relief can be granted on any sustainable legal theory "regardless of consistency, and whether based on legal or equitable grounds, or both"; Rule 8 (e) (1) (2) F. R. C. P., and, where the prayer or demand for relief is no part of the claim and the dimensions of the lawsuit are measured by what is proven. *Western Machinery Co. v. Consolidated Uranium Mines*, 247 F. 2d 685; *Gins v. Mauser Plumbing Supply Co.*, 148 F. 2d 974.

When the complaint is judged in the context of the philosophy of these modern procedural concepts, we are convinced that the election of remedies is inapplicable here. While the court applied the election of remedies with controlling effect, it seemingly weighed the equities as in restitution, and resolved them against the government. In any event, it found equitable grounds for holding the government to its original election. But judging the measure of relief to be granted under equitable restitution, we do not

think the equities weigh in appellants' favor. In its motion to amend, filed in July 1951, the government alleged that it had been apprised of the fact that the Bernsteins had made a large profit on the sale of the heaters, and that if fraud was established, they would be liable for such profits. On this basis, leave was granted to amend to demand restoration or restitution. And, the trial court denied appellants' motion to require the government to stand upon its original demand. When the court required the government to elect one of its available remedies, it finally demanded restoration or restitution. The original demand or election was pleaded as a defense. The record shows that sixty-nine percent of the merchandise was sold prior to the original complaint, and that most of the remainder of the merchandise was sold after notice was given of the government's intention to pursue its remedy in restitution. It cannot be said that the appellants proceeded in reliance upon the government's original election. Moreover, the appellants have no standing in equity to plead that their fraudulent pursuits would have been deterred by the severity of the penalty. We conclude that equitable restitution was available to the government.

The judgment on the appeal is affirmed, and the judgment on the cross-appeal is reversed, with directions to grant restitution.

In the United States Court of Appeals  
for the Ninth Circuit

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UNITED STATES OF AMERICA, APPELLANT

v.

E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE AND HARLAN L. MCFARLAND, APPELLEES

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E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE AND HARLAN L. MCFARLAND,  
APPELLANTS

v.

UNITED STATES OF AMERICA, APPELLEE

---

On Appeal from the United States District Court for the  
Southern District of California, Northern Division

---

BRIEF FOR THE UNITED STATES AS APPELLEE

---

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FILED

JUL 16 1958





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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 15873

UNITED STATES OF AMERICA, APPELLANT

*v.*

E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE AND HARLAN L. MCFARLAND, APPELLEES

---

E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
SCHWARTZE AND HARLAN L. MCFARLAND,  
APPELLANTS

*v.*

UNITED STATES OF AMERICA, APPELLEE

---

On Appeal from the United States District Court for the  
Southern District of California, Northern Division

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**BRIEF FOR THE UNITED STATES AS APPELLEE**

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This brief is filed in answer to "Appellants' Opening Brief" filed by defendants. In their brief as appellants, defendants attack the judgment below on two grounds: First, they argue that this suit

for civil damages under Section 26 of the Surplus Property Act of 1944, 58 Stat. 765, 50 U.S.C. App. (1946 ed.) 1635, is barred by the five year statute of limitations 28 U.S.C. 2462. Secondly, they argue that the district court's finding of fraud is not supported by the evidence. This brief will meet both contentions.<sup>1</sup>

### STATEMENT OF THE CASE

The Government instituted this suit under the fraud provisions of the Surplus Property Act of 1944, 58 Stat. 765, 50 U.S.C. App. (1946 ed.) 1611 *et seq.* to recover civil damages arising from the defendants' fraudulent acquisition of surplus property in violation of the Act. The substance of the charge is that defendant E. B. Hougham, individually and doing business as Baker's Motor Market, used each of the other defendants<sup>2</sup> as front men to purchase for him with their veteran's priority certificates surplus-property vehicles to which Hougham was not otherwise entitled. After a full trial, the district court found that the defendants were guilty of fraud as charged (R. 105-114) and that the action was not barred by the statute of limitations relied upon, because that statute was not applicable to actions under

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<sup>1</sup> The Government has filed a separate brief as appellant urging that the district court, in determining the quantum of damages, erred in limiting the Government's recovery to \$8000.00.

<sup>2</sup> Owen Dailey, William E. Schwartz. and Harlan L. McFarland.

the Surplus Property Act (R. 47, 117-118).<sup>3</sup>

Each of the veteran-defendants filed with the War Assets Administration an application for a veteran's priority certificate to enable him to purchase war surplus material on a priority basis <sup>4</sup> (R. 127-130, R. 206-209, R. 218-220, R. 227-228). On the basis of the representations in these applications, priority certificates in varying amounts were issued to each of the veterans enabling them to purchase surplus property at sales all over the country on a priority basis. Each of these applications described an established business (R. 127, 207, 219, 227) and in each the veteran represented and certified that

I am, or will be, directly or indirectly, the sole proprietor of the enterprise described herein, or, that no person or persons, other than veterans, have or will have any proprietary interest in the enterprise, singly or together, directly or indirectly, in excess of 50 per cent of either the capital invested in the enterprise or of the gross profits or income thereof; \* \* \* *that said property is to be used in and as part of the enterprise described herein.* (Emphasis supplied.) (R. 208, 219, 228).<sup>5</sup>

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<sup>3</sup> The district court initially held that the statute of limitations found in 28 U.S.C. 2462 was applicable to actions under Section 26(b) of the Surplus Property Act, but that this action was nevertheless timely (R. 44-45). However, it later revised this ruling and held that no statute of limitations was applicable to this action. (R. 47).

<sup>4</sup> Harlan L. McFarland filed two applications.

<sup>5</sup> The certification signed by Owen Dailey was in substance the same, but in wording somewhat different:

I certify:

\* \* \* \*

That the property applied for is the initial stock,



The district court concluded "from all of the evidence that as far as any enterprise of these three men it was purely synthetic \* \* \* [T]hese men were largely messenger boys in acquiring the surplus vehicles that Mr. Hougham felt he could use in his business" (R. 443). The testimony on which this conclusion is based may be summarized as follows:

#### OWEN DAILEY

Owen Dailey had been a representative of Firestone Tire and Rubber Company before the war (R. 166). When he was released from the service on June 27, 1946 (R. 128), he accepted a position as manager of defendant Hougham's used car lot which was styled Baker's Motor Market (R. 134). Dailey's salary was \$400.00 per month (R. 134). On July 29, 1946, Dailey made his application for a veteran's priority certificate (R. 134), and thereafter from July 31, 1946 to September 30, 1946, purchased with this certificate \$13,671.02 worth of surplus-property vehicles (R. 107, 61).

In his certificate Dailey represented, in addition to the matters mentioned above, that he was the only individual "financially interested" in the enterprise (R. 127) and that his working capital was "\$35,000.00—Personal Fund, Bank of America" (R. 128).

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necessary to establish or maintain the enterprise described herein, \* \* \*

\* \* \* \*

That I am not purchasing the property described herein for the benefit of any other enterprise, dealer, broker, merchant, or other undisclosed partner or principal. (R. 129).

At the trial, he admitted that at the time of the application his personal account was "probably in the red" (R. 188) and that a letter of financial responsibility from the Bank of America which he submitted to the War Assets Administration (R. 132) was supplied to him by Hougham and signed by a bank vice president whom Dailey had never seen before or since (R. 187-188). In a statement to the F.B.I., Dailey admitted that the funds for his purchases were "entirely supplied by Baker's Motor Market to whom I executed bills of sale for each item as it was purchased" (R. 135). For each of the items which Dailey thus "sold" to Hougham, Dailey was paid \$10 (R. 178, 188-189). Mr. Hougham referred to this \$10 payment as a "buying fee" (R. 380) or "buyer's fee" (R. 383). All of the items purchased on Dailey's priority were disposed of by Baker's Motor Market (R. 135).

The vehicles, which Dailey maintained were his own, were delivered to Baker's Motor Market, where, according to Dailey, he had arranged for storage (R. 171). Hougham made no storage charge (R. 181). The vehicles, once delivered, were repaired, often by other employees of Baker's Motor Market (R. 180). No records were kept of these repairs and no charge was made for them (R. 180-181). Parts were taken from the stock of Baker's Motor Market to repair "Dailey's vehicles" without charge (R. 180). When one of "Dailey's vehicles" needed glass work, this was done by another shop in Bakersfield (R. 182-183). The bill was paid by Baker's Motor Market (R. 183). Finally, Dailey testified that no interest

was charged on the purported loan to finance his purchase and that the loan itself was not evidenced by a writing (R. 176-177, 190). When Dailey wished to make a veteran's priority purchase, Hougham simply gave him the cash or Dailey got the cash from the bank on Hougham's instructions (R. 174-175). Despite the fact that Dailey testified that he was interested in operating his own business in vehicles available to the public and that Hougham was in the same situation, Dailey told the court that there was no competition between the two men (R. 200-201).

On the basis of this testimony the district court concluded that Hougham and Dailey "entered into agreements with one another to use Owen Dailey's veteran's priority certificate to obtain surplus property for E. B. Hougham from the War Assets Administration" (R. 107).

#### HARLAN L. McFARLAND

The pattern established by the testimony with respect to Dailey was in large part repeated in the case of defendants McFarland and Schwartze.

Harlan L. McFarland made two applications for veteran's priority certificates, one in March 1946, the other in July 1946 (R. 218-220, 226-227). Both contained the certifications quoted above, *supra* p. 3. On the basis of these applications, McFarland purchased from March 21, 1946, to September 16, 1946, \$27,710.51 worth of surplus-property vehicles (R. 112-113, 71).

On the second of these applications, McFarland

listed his business address as "McFarland Motors, 2401 East 14th St., Oakland Alameda Calif." (R. 227). McFarland testified that he never conducted a business at that address, knew no one at that address and had no intention of conducting a business in Oakland at all (R. 333). McFarland acknowledged that the false address entry was in his handwriting (R. 352-353)<sup>6</sup>. Yet McFarland had no explanation as to where he got the address. (There was, in addition, a San Francisco address listed in McFarland's handwriting that had been crossed out (R. 227). McFarland had no explanation for this address either (R. 331-332).) It should be noted at this point that the other veteran-defendant William Schwartze also had a false San Francisco address on his application which he testified was given to him by Hougham (R. 286); see *infra*, p. 9.

The enterprise described in McFarland's application was McFarland Motors. There had been a McFarland Motors in the thirties operated first by McFarland's mother and brother and then by McFarland and his mother (R. 222). During the war how-

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<sup>6</sup> Q. [by Mr. Conron] \* \* \* I don't suppose you have any independent recollection right now, this minute, as to whether or not you personally did make that entry in that application with your own hand, do you? Independent recollection?

A. [by Mr. McFarland] It looks like my writing.

Q. Do you have any independent recollection?

A. No.

Q. Now listen to my questions and answer them. (R. 352-353).

ever, the business remained inactive (R. 223).

The arrangements Hougham had with McFarland were similar to those with Dailey. According to Hougham, he supplied McFarland with all the capital to make the purchases listed in the complaint (R. 378). It would appear from McFarland's testimony that McFarland made some other purchases with his own capital (R. 317, 318). Apparently, McFarland retained the vehicles he purchased with his own capital and sold them from his lot (R. 317). On the vehicles purchased with Hougham's capital (and this includes all the vehicles listed in the complaint (R. 378)), the vehicles would be delivered to Baker's Motor Market and McFarland would be paid his \$10 (R. 317). This \$10 fee was paid by Hougham on each vehicle regardless of the condition of the vehicle or the resale price by Hougham (R. 342, 372, 384-385). Moreover, McFarland and Hougham together went over catalogs of war surplus material offered at these sales to determine which ones should be purchased by McFarland (R. 346). Hougham also paid McFarland's expenses when attending war surplus sales (R. 339).

In a sworn statement McFarland admitted that "I was doing him [Hougham] a favor by acting as his buyer at these sales" (R. 223). At the trial where McFarland was defending his actions on the basis of their being bona fide sales to Hougham, McFarland admitted that in the case of 25 particular units, he had resold them to Hougham prior to his own purchase (R. 322).

As in the case of Dailey, McFarland paid no in-



terest on the purported loan and no written records were kept of the transaction (R. 316).

The district court concluded that Hougham and McFarland "entered into agreements with one another to use Harlan L. McFarland's veteran's priority certificate to obtain surplus property for E. B. Hougham from the War Assets Administration" (R. 112).

#### WILLIAM E. SCHWARTZE

William E. Schwartz's application for a veteran's priority certificate was made on March 20, 1946 (R. 206-208). On the basis of this application, he received a veteran's priority certificate which enabled him to purchase \$38,131.13 worth of surplus property on a priority basis (R. 110, 64-65).

On his application, Schwartz listed the address of his truck rental business as "525 Jones St., San Francisco" (R. 207). Schwartz testified that he got the address from Hougham, but that he had never heard of it otherwise (R. 286). Hougham testified from a picture of 525 Jones Street that it looked like a garage in which he used to park repossessions in the 20's and 30's (R. 409). Schwartz never operated a business at that address or a truck rental business at all (R. 299).

Schwartz was Hougham's stepson and as such he had an open drawing account at Baker's Motor Market on which he drew for his needs and his wants (R. 285). In addition, he had the use of Hougham's charge accounts, both personal and business (R. 285). In view of this arrangement, Schwartz was not paid

the usual \$10 commission paid to Dailey and McFarland (R. 302-303).

All of Schwartz's war surplus purchases were financed by Hougham (R. 390). Delivery of the vehicles was made to Baker's Motor Market (R. 293). Every vehicle which Schwartz purchased was disposed of through Baker's Motor Market (R. 393). All the profit on the sale of the vehicles went to Baker's Motor Market (R. 394). All expenses for repairs were borne by Baker's Motor Market (R. 293-294, 394). Schwartz's expenses on buying trips were paid by Hougham (R. 294). Mr. Hougham admitted that Schwartz had no share in the profits of the business and was not regarded as a partner (R. 390). The agreement with him was that, in Hougham's own words, "He bought surplus at veterans' priority sales for our business" (R. 390).

Schwartz's explanation for his actions was that he had intended to go into the truck rental business with the surplus property he purchased, but that after his purchase he discovered that the trucks were wider than was allowed on California highways (R. 306-308). Accordingly, Schwartz disposed of the vehicles to Hougham. However, Schwartz offered no explanation as to why he did not purchase other surplus trucks that were not too wide after disposing of the others to Hougham. Moreover, he admitted that many of the vehicles, such as five bomb carrier trailers and a one and one-half ton 1940 Dodge truck were not purchased for the truck rental business, but for Baker's Motor Market (R. 296-299).

The district court concluded that Hougham and

Schwartz "entered into agreements with one another to use William E. Schwartz's veteran's priority certificate to obtain surplus property for Hougham from the War Assets Administration" (R. 109).

### STATUTES INVOLVED

1. The pertinent provisions of Section 26 of the Surplus Property Act of 1944 are set forth at pages 6-7 of the "Brief for the United States as Appellant".

2. 28 U.S.C. 2462 provides as follows:

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

### ARGUMENT

#### I

The District Court's Findings Of Fact That The Defendants Were Guilty Of Fraud Are Not Clearly Erroneous

#### A. *Scope of Review: The "Clearly Erroneous" Rule.*

This Court need not be reminded of its limited function in reviewing a district court's findings of fact. The effect of the "clearly erroneous" rule, Rule 52(a), F.R.C.P., has been too often treated by this <sup>7</sup>

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<sup>7</sup> *General Casulty Co. v. School District No. 5*, 233 F. 2d 526 (C.A. 9); *Barry v. Lawrence Warehouse Co.*, 190 F. 2d

and other courts to warrant further exposition here. Suffice it to say that the Rule's additional admonition that "due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses" is peculiarly applicable to a fraud case of this sort, where the demeanor of witnesses may be crucial to the outcome, but is nevertheless inevitably lost in the pages of a printed record. As Mr. Justice Jackson has written, "Findings as to the design, motive and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them." *United States v. Yellow Cab Co.*, 338 U.S. 338, 341.

***B. The findings of fraud are not clearly erroneous because they are supported by substantial evidence.***

With a summary of the evidence before the court as well as a statement of the scope of review, little more need be said. The conclusion below—if not compelled—can by no stretch of the imagination be characterized as clearly erroneous.

The facts present the standard elements in the typical veteran's front fraud—the purchase of large amounts of surplus property by inpecunious veterans with money supplied by Hougham, Hougham's failure to charge interest on the loan, failure to evidence the transactions by written documents, Hougham's payment of the veterans' expenses at the sales, immediate delivery of the property to Hougham, repairs made to the property by Hougham without charge, disposal of all the property by Hougham after a pur-

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433 (C.A. 9); *West v. Conrad*, 182 F. 2d 255 (C.A. 9); *United States v. Fotopulos*, 180 F. 2d 631 (C.A. 9); *Pacific Portland Cement Co. v. Food Machinery & Chemical Corp.*, 178 F. 2d 541 (C.A. 9).

ported sale to him, and finally payment to the veterans of a \$10 "buying fee" for each vehicle delivered regardless of the cost of the vehicle to the veteran, regardless of the condition of the vehicle, and regardless of the amount for which the vehicle was later sold by Hougham. It would be impossible, we submit, for the Government in any case to present to a court more compelling evidence of fraud than was adduced here.

In a case under this same Act which presents similar evidence to that in the case at bar—supplying of money to a veteran, false statements on application, veteran accompanied to sale by non-veteran, immediate "resale" by veteran to non-veteran—this Court reversed a district court finding of no fraud as clearly erroneous. *United States v. Comstock Extension Mining Co.*, 214 F. 2d 400 (C.A. 9).

Moreover, the Fifth Circuit recently affirmed a finding of fraud under this Act evidenced only by a fraction of the badges of fraud present here, *Daniel v. United States*, 234 F. 2d 102 (C.A. 5), certiorari denied, 352 U.S. 971. The court in *Daniel* quoted approvingly from the district judge's oral opinion (234 F. 2d at 105):

"The fact that witnesses testified that the defendant Daniel furnished the money and was working with each of the witnesses, and put up the money to purchase, and in one instance, at least, went with the purchaser when he did purchase, and each of these purchasers were veterans entitled to purchase government property at a lower scale than anyone else could purchase



it; under that state of facts I believe that the defendant Daniel knew that these veterans were going to get these certificates and to use them in the purchase of this property. It is almost an insult to one's ability to connect testimony and to discover where the truth lies to make any other conclusion. He put up the money. He got the things that were purchased. He knew they were veterans. And, as I have already said, in at least one instance went with him down there where the sales were made to the veterans.

\* \* \* \*

“I, therefore, conclude, as a matter of law that judgment must go for the plaintiff.”

*Bernstein v. United States*, Nos. 5704 and 5705, decided May 23, 1958 (C.A. 10)<sup>8</sup> is also factually close to the case at bar, although in *Bernstein* the proof of fraud was in many respects weaker than in the instant case, for there the purported loans and sales were evidenced by elaborate documents, the War Assets Administration was advised of the purported sale by the veteran, and only one veteran was used rather than establishing a pattern as was done here and in the *Daniel* case, *supra*, p. 13. But in many respects the *Bernstein* case presents the same elements as in the instant case such as the use of an employee and the presence of misstatements on the application form. Moreover, the same defenses urged in the instant case were relied on unsuccessfully in *Bernstein*:

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<sup>8</sup> The opinion in the *Bernstein* case is printed as an appendix to the Government's brief as appellant in this case.

\* \* \* [A]ppellants earnestly insist that Bensik purchased the property in his own right for his own account; that the subsequent sale of a major portion of it to Bernstein Brothers was not prohibited by any applicable regulation \* \* \*. In other words, the sale was “real and not a sham”, hence without fraud or actionable wrongdoing.

After noting that “it would undoubtedly be contrary to the spirit and purpose of the Surplus Property Act and actionably wrong, to use Bensik’s priority to obtain the property on behalf and for the benefit of Bernstein Brothers”, the Tenth Circuit concluded:

\* \* \* In determining in the last analysis whether Bensik purchased the heaters for his own account as an established dealer for resale, or as a mere broker or agent for Bernstein Brothers, it is significant to note that the gain he realized from the 510 heaters is more like a broker’s commission than an established dealer’s legitimate profit.

When the evidence is considered in its entirety, we are certainly unable to say that the inferences which the trial court drew from the established facts were unwarranted, and that its judgment thereon is clearly erroneous.

It is submitted that the same conclusion is called for here. In the light of the overwhelming evidence of fraud outlined above, it cannot seriously be argued that the district court’s findings will leave this Court with a “definite and firm conviction that a mistake has been committed”. *United States v. United States Gypsum Co.*, 333 U.S. 364, 395.

## II

**The District Court Correctly Decided That The Action  
Is Not Barred By 28 U.S.C. 2462 Because That Statute  
Of Limitations Is Not Applicable To Suits Under  
Section 26 Of The Surplus Property Act**

Defendants argue that this action is barred by the five-year statute of limitations found in 28 U.S.C. 2462, *supra*, p. 11. However, that statute applies only to a "civil fine, penalty, or forfeiture". It is now well-settled that the statute has no application to civil actions under Section 26(b) of the Surplus Property Act because the recovery permitted by Section 26 is not penal but civil, providing the Government with alternative measures of liquidated damages.

The character of the recovery under Section 26(b) of the Surplus Property Act was before the Supreme Court in *Rex Trailer Co. v. United States*, 350 U.S. 148, 151, where the Court held that " \* \* \* the recovery [under Section 26(b)(1)] is civil in nature. The Government has the right to make contracts and hold and dispose of property, and, for the protection of its property rights, it may resort to the same remedies as a private person \* \* \* Liquidated damages are a well-known remedy, and in fact Congress has utilized this form of recovery in numerous situations."

Although the question as to whether Section 26 (b)(1) was civil or penal in nature did not arise in *Rex Trailer* in the context of the applicability of the statute of limitations, it is clear from the manner in which the case reached the Supreme Court that the

Court regarded 26(b) as civil for purposes of the application of 28 U.S.C. 2462. In *Rex Trailer* the defendant had pleaded *nolo contendere* in a prior criminal proceeding based on the same transactions for which he was now being sued under Section 26 (b) of the statute. He argued that the later proceeding under 26(b) placed him twice in jeopardy in violation of the Fifth Amendment. This of course depended on whether the later action was civil or penal in nature. The Court noted in its opinion that certiorari was granted "to resolve an asserted conflict between the decisions of the Courts of Appeals" (350 U.S. at 149). In a footnote to this sentence the Court stated:

In considering whether the statute of limitations contained in 28 USC §2462 applied to §26 (b) (1) of the Surplus Property Act, the Fifth Circuit held §26(b) (1) to be a civil remedy in *United States v. Weaver* (Ala.) 207 F 2d 796, 797, and the Sixth Circuit held it to be penal in *United States v. Witherspoon* (Tenn.) 211 F. 2d 858. [350 U.S. at 149.]

In holding that the recovery was civil in nature for double jeopardy purposes it is clear that the Court also disapproved the decision of the Sixth Circuit in the *Witherspoon* case which held 26(b) (1) penal for statute of limitations purposes.

The defendants in their brief in the instant case rely on the *Witherspoon* case as their primary authority (Defendants' brief as appellants, p. 8), yet nowhere do they cite or discuss the effect of the *Rex Trailer* case on *Witherspoon* despite the fact that

the district court based its decision in the instant case on *Rex Trailer* (R. 44-47).

The Supreme Court in *Rex Trailer* also made it clear that subsections (2) and (3) as well as subsection (1) of 26(b) are civil in nature: "All three [of the remedies under Section 26(b)] were recognized as civil remedies by Congress before the bill was passed, and the conclusion is inescapable that each was of the same nature and designed to serve the same purpose." 350 U.S. at 151-2.

In a very recent decision squarely in point on this aspect of the case, the Court of Appeals for the Third Circuit, relying on the reasoning outlined above, has flatly ruled that the damage provisions of Section 26(b) of the Surplus Property Act are not penal in nature and that the five-year limitation statute is therefore inapplicable. (*United States v. Doman*, (C.A. 3), Nos. 12,371 and 12,372, decided June 17, 1958; this opinion is reproduced in an appendix to this brief for the Court's convenience.) The Third Circuit in *Doman*, stated: "We are of the opinion that Section 26(b) (1) does not provide for a penalty but is remedial in nature." See also *United States ex rel. Marcus v. Hess*, 317 U.S. 537; *United States v. Barish*, No. 12,395, decided June 18, 1958 (C.A. 3) (The precise question as in the *Doman* case was raised and the court disposed of it *per curiam* on the basis of *Doman*); *United States v. Schneider*, 139 F. Supp. 826 (D.C.S.D.N.Y.). But cf. *Erie Basin Metal Products, Inc. v. United States*, 150 F. Supp. 561 (C. Cls.)



It is also significant here that *Doman* makes it plain that the holding of non-applicability of any statute of limitations to suits by the Government under the Surplus Property Act applies with equal force irrespective of the particular subsection of Section 26(b) under which the Government seeks damages:

Moreover, it should be noted that Section 26 (b) contains three subsections. The latter two clearly provide for multiple damages in the form of or as liquidated damages. These two subsections provide without question a remedy clearly compensatory in nature. Both the wording of Section 26(b) and the pertinent Committee Report, S. Rep. No. 1057, 78th Cong., 2d Sess., p. 14, show that the United States was to have the option of selecting as its remedy any one of the three different measures of damages. It is a reasonable construction of the section that Congress intended all three subparagraphs of Section 26(b) to be *in pari materia*.

The Third Circuit's decision that the statute of limitations in 28 U.S.C. 2462 is not applicable to suits under Section 26(b) of the Surplus Property Act is, we submit, undoubtedly correct and should be followed here. 28 U.S.C. 2462, accordingly, is no bar to the present action.

## CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment below should be affirmed with respect to the defendants' appeal.

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LAUGHLIN E. WATERS,  
*United States Attorney,*

MORTON HOLLANDER,  
HERSHEL SHANKS,  
*Attorneys,*  
*Department of Justice.*

## APPENDIX

UNITED STATES COURT OF APPEALS  
FOR THE THIRD CIRCUIT

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No. 12,371

---

UNITED STATES OF AMERICA

*v.*

EDWARD DOMAN, ALEXANDER JOSEPH DOMAN, RAYMOND JEREAN KOLLER, MORTON ZEIDMAN, HOWARD ALBERT BORDEN, JACK LEONARD ERLBAUM, JOHN DANIEL GUILLE, MARTIN SILVERBROOK, JOSEPH HENRY GREENSTONE, STANLEY BEAR, LIBERS ERSAL SHIPTON, MORRIS SHNEER.

RAYMOND JEREAN KOLLER,

*Appellant.*

---

No. 12,372

---

UNITED STATES OF AMERICA

*v.*

EDWARD DOMAN, ALEXANDER JOSEPH DOMAN, RAYMOND JEREAN KOLLER, MORTON ZEIDMAN, HOWARD ALBERT BORDEN, JACK LEONARD ERLBAUM, JOHN DANIEL GUILLE, MARTIN SILVERBROOK, JOSEPH HENRY GREENSTONE, STANLEY BEAR, LIBERS ERSAL SHIPTON, MORRIS SHNEER.

MARTIN SILVERBROOK,

*Appellant.*

---

APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

---

Argued February 19, 1958

Before BIGGS, *Chief Judge*, and GOODRICH and Mc-  
LAUGHLIN, *Circuit Judges*

OPINION OF THE COURT

(Filed June 17, 1958)

BY BIGGS, Chief Judge.

The two appeals at bar, arise out of a single case in the court below, and may be appropriately disposed of in a single opinion. This civil suit was instituted against the defendants under Section 26(b) (1) of the Surplus Property Act of 1944<sup>1</sup> to recover the sum of \$2,000 and double damages for each of several fraudulent transactions alleged to have been engaged in by the defendants.

The United States filed motions for summary judgment against each of the defendants. Set out in the motions, as their bases, were indictments handed down against Koller and Silverbrook and others, alleging violations of Title 18, USC, 1940 ed. § 80 (Mar. 4, 1909) C. 321 § 35, 35 Stat. 1095. The asserted violations were that Koller and Silverbrook and others had engaged in a fraud upon the United States by filing false applications for priority in the

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<sup>1</sup> Act of October 3, 1944, ch. 479, 58 Stat. 765 as amended, repealed, and reenacted as of June 30, 1949, ch. 288, Title II, Section 209, 63 Stat. 392, 40 U.S.C. § 489.

purchase of property of the United States and were the identical acts alleged in the complaint in the present civil action. Both Koller and Silverbrook had pleaded guilty to the indictments and had been fined. The court below in the instant case correctly found that the pleas of guilty entered by Koller and Silverbrook in the criminal case referred to conclusively established the issue of fraud against them in the case at bar. On August 7, 1957 the court below entered judgment against both Koller and Silverbrook and the appeals at bar followed.

The acts complained of were committed by Silverbrook on March 15, 1946 and by Koller on July 12, 1945 and June 3, 1946. The complaint in the instant case was filed on May 12, 1955, more than nine years after the completion of the acts complained of. While the general rule is that the statute of limitations ordinarily does not run against the United States, *United States v. Summerlin*, 310 U.S. 414 (1940), where the action brought by the United States is for the enforcement of a civil fine, penalty, or forfeiture, the statute of limitations is five years.<sup>2</sup> The narrow issue, therefore, is whether Section 26(b)(1) of the Surplus Property Act, which requires a person committing the prohibited act to pay the United States the sum of two thousand dollars for each fraudulent act in addition to double the amount of any damages which the United States may have sustained by reason of Koller's and Silverbrook's activities provides a civil fine, a penalty, or a forfeiture, or merely compensatory damages.

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<sup>2</sup> "Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued . . ." 28 U.S.C. § 2462.



The United States, relying upon the opinion of the Supreme Court in *Rex Trailer Co. v. United States*, 350 U.S. 148 (1956), argues that the Surplus Property Act does not impose a civil fine, a penalty or a forfeiture and therefore the statute of limitations set forth in Section 2462, 28 U.S.C., does not bar suit on the claims before this court. Koller and Silverbrook contend that Section 26(b)(1) does impose a civil penalty and since the decision of the Supreme Court in *Rex Trailer* did not deal with the statute of limitations issue it affords no authority for the determination of the issue at bar. We cannot agree with defendants' contentions.

In *Rex Trailer* the Supreme Court had before it the issue of whether the *Rex Trailer Company*, which had pleaded *nolle contendere* to a charge of fraudulently purchasing motor vehicles under the Act, and had been fined in that criminal proceeding, was subjected to double jeopardy when sued by the United States in a civil action under Section 26(b)(1) to recover \$2,000 for each prohibited act, the acts complained of being those set out in the indictment in the criminal case. The court held in substance that the recovery sought under Section 26(b)(1) was civil in nature and did not put the *Trailer Company* in jeopardy in violation of the Fifth Amendment.

The principal question presented for decision in *Rex Trailer v. United States* was stated to be whether the provisions of Section 26(b)(1) are civil or criminal. While the issue in *Rex Trailer* was one of double jeopardy, the Court, 350 U.S. at p. 149, stated that certiorari was granted to resolve an asserted conflict between the decisions of the Courts of Appeals. In footnote 2 it stated, "In considering whether the statute of limitations contained in 28 U.S.C. § 2462 applied to § 26(b)(1) of the Surplus Property

Act the Fifth Circuit held § 26(b)(1) to be a civil remedy in *United States v. Weaver*, 207 F. 2d 796, 797, and the Sixth Circuit held it to be penal in *United States v. Witherspoon*, 211 F. 2d 858."

In holding that Section 26(b)(1) of the Surplus Property Act created a statutory right in the United States to recover liquidated damages which were thought by the Court to be reasonable, we believe that the Court intended to put at rest the "asserted" conflict between the circuits. See *United States v. Hougham*, 148 F. Supp. 715 (S.D. Cal. 1957); *United States v. Schneider*, 139 F. Supp. 826 (S.D. N.Y. 1956); dissenting opinion of Judge Madden in *Erie Basin Metal Products, Inc. v. United States*, 150 F. Supp. 561, 566-7. But see the majority opinion in *Erie Metal Products v. United States*, *supra*.

We are of the opinion that Section 26(b)(1) does not provide for a penalty but is remedial in nature. We are buttressed in this view by the opinion of the Supreme Court in *United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943). This case involved an action under the False Claims Act, 31 U.S.C.A. § 231, which contained language similar to that in Section 26(b)(1) of the Surplus Property Act. It provides that a person who commits certain frauds upon the United States "... shall forfeit and pay to the United States the sum of \$2,000, and in addition, double the amount of damages which the United States may have sustained. . . ." The Court held that this provision for the recovery of \$2,000 and double damages for each fraud was a compensatory civil remedy and therefore was remedial in nature. The Court stated, 317 U.S. at p. 551, "We think the chief purpose of the statutes here was to provide for restitution to the government of money taken from it by fraud, and

that the device of double damages plus a specific sum was chosen to make sure the government would be made completely whole.”

The opinion in *Marcus v. Hess* was handed down on January 18, 1943. The Surplus Property Act, which employed virtually identical language, was enacted on October 3, 1944. As Mr. Justice Clark stated in footnote 4 cited to the text at 350 U.S. at p. 152, of *Rex Trailer*, “Under these circumstances it would be very difficult to say that these words which provided a civil remedy in the False Claims Act were not intended to provide the same kind of remedy in the Surplus Property Act.”

Moreover, it should be noted that Section 26(b) contains three subsections.<sup>3</sup> The latter two clearly

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<sup>3</sup> Section 26(b) of the Surplus Property Act, Title 40 U.S.C. §489 provides as follows:

“(b) Every person who shall use or engage in or cause to be used or engaged in any fraudulent trick, scheme, or device for the purpose of securing or obtaining, or aiding to secure or obtain, for any person any payment, property, or other benefits from the United States, or any Government agency in connection with the disposition of property under this Act; or who enters into an agreement, combination, or conspiracy to do any of the foregoing—

“(1) shall pay to the United States the sum of \$2,000. for each such act, and double the amount of any damage which the United States may have sustained by reason thereof, together with the costs of suit; or

“(2) shall, if the United States shall so elect, pay to the United States, as *liquidated damages*, a sum equal to twice the consideration agreed to be given by such person to the United States or any Government agency; or

“(3) shall, if the United States shall so elect, restore to the United States the property thus secured and

provide for multiple damages in the form of or as liquidated damages. These two subsections provide without question a remedy clearly compensatory in nature. Both the wording of Section 26(b) and the pertinent Committee Report, S. Rep. No. 1057, 78th Cong., 2d Sess., p. 14, show that the United States was to have the option of selecting as its remedy any one of the three different measures of damages. It is a reasonable construction of the section that Congress intended all three subparagraphs of Section 26(b) to be *in pari materia*. We cannot hold that Congress intended that the first of the three subsections set up a penalty section and the other two provided merely for compensatory liquidated damages.

The fact that Section 26(b) (1) allows for the recovery of \$2,000 in addition to the double damages does not make that section punitive. In *Helvering v. Mitchell*, 303 U.S. 391 (1938) a 50% assessment upon those who committed fraud under the Revenue Act of 1928 was not considered a penalty, but rather was held to be a civil administrative sanction of a remedial nature. See *Scadron's Estate v. Commissioner*, 212 F. 2d 188 (2 Cir. 1954), cert. den. 348 U.S. 832 (1954); *Kirk v. Commissioner*, 179 F. 2d 619 (1 Cir. 1950); *Reimer's Estate v. Commissioner*, 180 F. 2d 159 (6 Cir. 1950).

The nature of the recovery is not altered by the inability of the United States in the case at bar to show actual damage, since, as was held in *Rex Trailer Co.*, the remedy provided by 26 (b) (1) is comparable to a recovery under a liquidated damage provision

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obtained and the United States shall retain as *liquidated damages* any consideration given to the United States or any Government agency for such property." (Emphasis added.)

which fixes compensation for anticipated loss. That the United States had a legitimate proprietary interest in insuring the disposal of its surplus materials to veterans in accordance with the announced policy and objectives of the Surplus Property Act, and that it suffered compensable damage under the statute by defendants' manifest perversion of that policy are propositions which have been settled beyond the need for further review. *Rex Trailer Co. v. United States*, *supra*; *United States v. Bound Brook Hospital*, 251 F. 2d 12 (3 Cir. 1958); *Daniel v. United States*, 234 F. 2d 102 (5 Cir. 1956).

We conclude that Section 26(b)(1) provides for compensatory damages, and that the statute of limitations, Section 2462, 28 U.S.C., did not bar this action in the court below. The judgment of the court below will be affirmed.



No. 15,873

IN THE

United States Court of Appeals  
For the Ninth Circuit

---

UNITED STATES OF AMERICA,  
*Appellant,*

vs.

E. B. HOUGHAM, OWEN DAILEY, WIL-  
LIAM E. SCHWARTZE and HARLAN L.  
McFARLAND,  
*Appellees.*

On Appeal from the United States District Court  
for the Southern District of California,  
Northern Division.

REPLY BRIEF OF APPELLEES

E. B. HOUGHAM, OWEN DAILEY, WILLIAM E. SCHWARTZE  
AND HARLAN L. McFARLAND.

---

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FILED

JUL 18 1958

PAUL P. O'BRIEN, CLERK



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No. 15,873

IN THE

**United States Court of Appeals  
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---

UNITED STATES OF AMERICA,

*Appellant,*

VS.

E. B. HOUGHAM, OWEN DAILEY, WIL-  
LIAM E. SCHWARTZE and HARLAN L.  
McFARLAND,

*Appellees.*

On Appeal from the United States District Court  
for the Southern District of California,  
Northern Division.

**REPLY BRIEF OF APPELLEES**

**E. B. HOUGHAM, OWEN DAILEY, WILLIAM E. SCHWARTZE  
AND HARLAN L. McFARLAND.**

---

In a separate appeal the Defendants E. B. Hougham, Owen Dailey, William E. Schwartz and Harlan L. McFarland have urged this Court to reverse the judgment of the District Court on the ground that the action is barred by the Statute of Limitations, that the Findings of Fact and Conclusions of Law are defective, and upon the ground that the evidence is insuffi-

cient to support a finding of any trick, scheme or device.

The Government has appealed claiming that the District Court erred in denying it the right to change the form of relief requested from \$2,000.00 per act to twice the consideration paid.

It attempts to raise the question of when and how it must choose the alternative relief afforded it as a civil penalty under the provisions of the War Surplus Act of 1944.

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#### **REPLY TO GOVERNMENT'S POSITION.**

It is submitted that the Government should be denied the right to change the form of relief requested, for the following reasons:

1 The Government failed to raise the points urged in its specification of errors in the Trial Court and cannot be allowed to raise them for the first time on appeal.

2. It elected its form of remedy by filing the action and asking for the sum of \$2,000.00 as a civil penalty for each act.

3. Assuming, but not conceding, that the election was not complete at the time of the filing of the action, it waived its right to elect twice the consideration agreed to be given by:

- (a) Withdrawing the First Amended Complaint;
- (b) Offering the Second Amended Complaint;
- (c) Proceeding to Judgment on the Second Amended Complaint.

4. The Government is estopped to change its position because defendants will suffer prejudice if it is allowed to do so.

5. The cause of action set forth in the First Amended Complaint is barred by the Statute of Limitations.

6. It would be entitled to no relief under the prayer of the First Amended Complaint upon the facts pleaded because no monies were alleged to have been "agreed to be given".

7. The Trial Court has found upon the evidence that the trick or device here involved did not embrace "monies agreed to be given".

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#### POINT 1.

**THE GOVERNMENT FAILED TO RAISE THE POINTS URGED IN ITS SPECIFICATION OF ERRORS IN THE TRIAL COURT AND CANNOT BE ALLOWED TO RAISE THEM FOR THE FIRST TIME ON APPEAL.**

Although the Government's pre-trial assertions of issues to be litigated upon the trial include the contention of the plaintiff that it is entitled to double the sale price of the vehicles (101), it failed to present the point to the Court below. The Second Amended Complaint, upon which plaintiff went to trial, contained no such prayer. On the contrary, it prayed for \$2,000.00 damages per act (55, 72-73).

The only place in which the contention is made is in the First Amended Complaint (25, 42-43).

Although a motion was made to file the First Amended Complaint in lieu of the original Complaint (23), this motion was never pressed, but, on the contrary, was voluntarily withdrawn by the Government. In the Memorandum Opinion of Judge Jerthberg (43-52), the pertinent portion reads:

“Prior to ruling on these motions (defendants’ Motion to Dismiss and plaintiff’s Motion to File First Amended Complaint) and on December 21, 1956, pursuant to Rule 15 (a) of Federal Rules of Civil Procedure, plaintiff moved for an order permitting the filing of a Second Amended Complaint, on the ground that the Second Amended Complaint was made to conform to the proof that that the plaintiff intends to submit at the trial in support of its claim for relief, *and in that motion plaintiff withdrew the proposed First Amended Complaint.*”

and on page 49:

“The remaining motion to be considered is the motion of plaintiff for an order permitting the filing of a Second Amended Complaint.”

and on page 54:

“The motion of plaintiff to file the Second Amended Complaint and to withdraw the proposed First Amended Complaint is granted.”

It will thus be seen that the point never was presented to the Court below, and the Court below did not err “in holding that the United States irrevocably elected its choice of statutory remedies for fraud by filing its original Complaint (Specification of



Error No. 1, Appellee's Brief, page 9)”, and did not err “in refusing to allow the Government to amend its initial Complaint with respect to damages”. (Specification of Error No. 2, page 9.) Although a motion was made to file the First Amended Complaint, the Government for reasons of its own voluntarily abandoned this position on December 21, 1956, prior to the ruling on the motion to file the First Amended Complaint, by filing the motion to file the Second Amended Complaint (48). It argued and submitted its second motion to the Court on January 14, 1957. The motion was granted January 18, 1957 (55).

The Pre-Trial Conference Order was not prepared until August 31, 1957 (104), long after the Government had waived the right to further urge the point. The rule is well settled that a litigant may not for the first time on appeal raise a question not first submitted to the Trial Court and ruled upon at that level.

*Hecht v. Alfaro*, 10 Fed. 2d 464;

*Union Wire Rope Corp. v. A. T. & S. F. Rwy.*, 66 Fed. 2d 905;

*N. Y. & T. Land Co. v. Gulf W. T. & P. R. Co.*, 100 Fed. 830, 41 C.C.A. 87.

The fact that the matter was injected into the Findings and Conclusions of Law in Conclusion No. 3 (115-117) cannot aid the Government, for Findings and Judgments must have a basis in the pleadings and in the evidence. A Judgment on a matter outside of the issues raised by the pleadings must of necessity be altogether arbitrary and unjust as it

attempts to conclude a point on which the parties have not been heard. A material variance arises where a party pleads one cause of action and attempts to prove another and different one. It follows that a party must recover, if at all, upon the case made by his pleadings. 41 *Am. Jur.* 555, 556.

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## POINT 2.

### THE GOVERNMENT ELECTED ITS FORM OF REMEDY OR RIGHT BY FILING THE ACTION AND ASKING FOR \$2000.00 AS A CIVIL PENALTY FOR EACH ACT.

The Government elected by filing the original Complaint. The prayer of the original Complaint is for \$2,000.00 per act (Paragraph VIII, page 9, and prayer, page 22).

Section 26 of the War Surplus Act of 1944, 50 U.S.C.A. 1635(b) provides in part:

“Every person . . . who enters into an agreement, combination or conspiracy to do any of the foregoing (1) shall pay to the United States the sum of \$2000.00 for each such act . . . or (2) shall, *if the United States shall so elect*, pay to the United States as liquidated damages a sum equal to twice the consideration agreed to be given by such person to the United States or any government agency, or (3) *if the United States shall so elect* restore to the United States the property . . .”

By the very terms of the Act itself only one remedy may be chosen, and the choice of one necessarily excludes the remainder. The Government made

this choice at the time of filing the original Complaint.

28 C.J.S. 1057 provides:

“an election of remedies is the adoption of one of two or more co-existing remedies, with the effect of precluding a resort to the others.”

And at page 1088:

“The commencement of any proceeding to enforce one remedial right, in a court having jurisdiction to entertain such proceeding, is such a decisive act as constitutes a conclusive election, barring the subsequent prosecution of inconsistent remedial rights . . .”

*U. S. v. Oregon Lumber Co.*, 260 U.S. 290, 67 L.Ed. 261, 43 S.Ct. 100;

*Minneapolis Nat. Bank of Minneapolis, Kan. v. Liberty Nat. Bank of Kansas City*, C.C.A. Kan., 72 F. 2d 434.

*United States v. Oregon Lumber Company*, supra, on page 295 states:

“Any decisive action by a party with knowledge of his rights, and of the facts, determines his election in the case of inconsistent remedies, and one of the most unequivocal of such determinative acts is the bringing of a suit based on one or the other of these inconsistent conclusions.”

Since the remedies provided in the War Surplus Act are co-existent the choice of one made at the time of the filing of the complaint excludes the oth-

ers, and plaintiff should not be allowed at a later date to change its theory and form of action. The Act, in effect, says: "Here are three apples. Choose one." or "Take this one, unless you elect one of the other two."

The Government argues that the congressional intent was to provide for "the honest administration of the Act". We have no dispute with this assertion. The Act amply so provides, without distorting its language.

We dispute, however, its contention that in order to provide for the honest administration of the Act, in addition to criminal sanctions the Government is given three civil remedies against those who defraud. By the language of the Act itself it is not given three remedies. It is given one statutory remedy, and it is told in explicit language to elect one remedy from a choice of three alternatives:

1. \$2000.00 per act;
2. Twice the consideration "agreed to be paid" (if any); and
3. Return of the property.

The purpose of the Act is to promote the honest administration of justice by providing remedies in different forms to meet different situations. Yet the Government seeks to place an interpretation upon the Act liberally construing it in its own favor, above and beyond the reasonable and clear language thereof, with the obvious end in view of transforming it into a dollar-making machine regardless of

the equities involved. Such a position is not justice; it is persecution.

The Act, being penal in nature, should be strictly construed against, and not in favor of, the Government. *Rainwater v. United States*, 78 Sup. Ct. Rep. 946.

50 *Am. Jur.* at page 432 states:

“The ordinary application of the rule of strict construction of penal statutes is to statutes that impose punishment for the commission of a crime. However, the rule as to strict construction of penal law is also applied to statutes not strictly criminal but of that nature. It prevails as to retaliatory statutes and statutes which impose penalties or forfeitures which provide for a recovery of damages beyond just compensation to the party injured.”

This is clearly such a statute. It says the Government shall select one of three alternative remedies. This necessarily means that the selection of one is an abandonment of the other two. This the Government did at the time of the filing of the original complaint. It did so with full knowledge of all of the pertinent facts, as will be noted by comparison of the items involved in the original and the First Amended Complaint. They are identical, with one minor exception, a truck. (50)

The Government argues that the holding of the Court below “closed the door on the other remedies which the statute provides”. This argument is fallacious. The provisions of the Act itself close the



door on the other remedies after the selection is made by the Government. Should Congress decide that a different method of "closing the door" is appropriate it could amend the Act; it is not for the Courts, by judicial construction, to evade the Act.

The Government suggests that the ruling of the Court allows these defendants to escape "the full measure of damages stipulated by the Act". Such a suggestion is grim humor, to say the least. By the judgment of the Court these defendants have been assessed the full measure of damages provided by the Act for the alleged wrongs which were established by the evidence.

The case of *Bernstein v. U. S.* is relied upon. That decision is not yet final and is distinguishable from the case at bar in many respects, which will be hereafter noted.

The first feature distinguishing the two cases, as has been noted in Point 1, is the manner in which the question involved was presented in the Court below. In the *Bernstein* case a record was made in the Court below from which the point there involved could be successfully presented to the Circuit Court. There is a deficiency in this record in that respect.

The second distinction appears in the type of relief sought in the two cases, which brings into play entirely different lines of reasoning. In the *Bernstein* case it was noted that the War Surplus Act provides one of three alternative remedies specified in the Act, *and, in addition, common law remedies when applicable.*

In the original Complaint in the *Bernstein* case the "double the monies agreed to be paid" phase of the War Surplus Act was relied upon, and a specific and definite statement of this election of one of the three alternative statutory remedies was made in the Complaint. At a much later date a common law remedy, to-wit, rescission, plus resulting trust theory, was injected into the case by an amended pleading, which was allowed in the Trial Court. The Government never attempted to select a second statutory remedy.

To this so-called common law theory, the defense of election of remedies was raised by Answer, and a finding favorable to the election was made by the Trial Court after taking full evidence upon the subject. The Opinion of the Circuit Court in that appeal is directed not to the question of alternative remedies specified by the War Surplus statute but to the question of whether or not the common law doctrine of election of remedies should be applied at the time of filing the original action or at a later date, or at all. There is no such question before this Court in this appeal. Here the question involves not the common law application of the doctrine of election of remedies but it involves the mandatory requirement of the election of one of three remedies, contained in the specific language of the War Surplus Act itself.

In the instant case the specific question is when, under the War Surplus Act, must the Government elect the alternative civil remedy? At the time of

filing the action? At a later date, before trial? Or may it harass a litigant through a trial and exercise its judgment of hindsight and select an alternative that it thinks might be more excruciating? The *Bernstein* opinion has no bearing upon this problem and its decision is of no assistance whatsoever to this Court.

The reasoning of the *Bernstein* case is faulty in that it relies upon Rule 8 (e) F.R.C.P. which states that a pleading is a simple concise statement of the operative facts upon which relief can be granted upon any ordinary sustainable legal theory regardless of consistency *where the prayer or demand for relief is no part of the claim and the dimensions of the lawsuit are measured by what is proven*. Here we do not have such a situation. On the contrary, we have a situation where the prayer is an essential element of the cause of action, since it necessarily formulates the alternative type of relief afforded by the War Surplus Act, which commands the election.

The opinion of Chief Justice Knous of the District Court in the *Bernstein* case, reported in 149 Fed. Supp. 568, is much more logical and better reasoned, and is adopted here in its entirety in refutation of the Opinion of the 10th Circuit. We are heartily in accord with his suggestion that *the Government should not be allowed to indulge in the practice of burning the candle at both ends*.

The Government suggests the concept that a complaint is simply general notice of the type of suit involved, which may be a proper concept of

pleadings generally. It has no bearing where an election of remedy is a necessary element of the type of relief claimed, and is made so by statute.

There is no merit to the suggestion that the requirement of selection of one of three alternative remedies, contained in the Surplus Property Act, might become a game of skill in which one misstep by counsel may be decisive. The Government had ten years to make up its mind. The case of *Hickman v. Taylor*, 329 U.S. 495, states:

“The new rules, however, restrict pleadings to the task of general notice giving.”

That task is not complete in a surplus property action until the type of remedy is selected.

Here we are not dealing with a general provision of substantive law but on the contrary with a statutory remedy. The remark of Judge Yankwich in *Ester v. Western Union*, 25 Fed. Supp. 578, would be appropriate in a substantive law case; however, the allegation of the type of damage sought is a necessary part of the statement of the cause of action itself in the instant case.

We have no quarrel with Rule 15, F.R.C.P. to the effect that liberal amendments shall be allowed when justice so requires. There has been an amendment allowed in this case in the interest of justice. The Government simply overlooks the fact that we are not dealing with the common law doctrine of election of remedies which may be exercised at varying times, dependent upon the circumstances;



we are, on the contrary, dealing with the statutory requirement of the Surplus Property Act of the selection of one remedy, and the abandonment of others. It would not be "justice" to allow the Government to procrastinate.

The final argument of the Government that we are not dealing with inconsistency of remedies is in a sense true. We are dealing with an Act which requires the selection of one remedy and the abandonment of others.

In a further sense, however, the argument is not sound for the remedies authorized by the Surplus Property Act are actually inconsistent. As pointed out in the *Bernstein* case, the overlying theory of recovery of the property (rescission and constructive trust) is inconsistent with the right to claim \$2,000.00 per act, or double the "monies agreed to be given".

Similarly, there are inconsistencies in a demand of "\$2,000.00 per act" and double the "monies agreed to be given", for in one the focus is upon the number of transactions, and in the other the focus is upon the monetary consideration "agreed to be given".

The type of trial preparation would differ radically, depending upon the nature of the demand. The number of transactions, not their monetary worth, becomes the focal point where the demand is \$2,000.00 per transaction, and the penalty is fixed. If the demand were double the consideration



“agreed to be given” the monetary element would predominate and the importance of the number of the transactions would diminish. A complete audit would be necessary, and a minute analysis of records, accounts, etc., would be required in order to prepare for such a case. In the trial of this case the foundation was waived in respect to all of the so-called financial documents (126), which never would have been the case had the demand been in a different form.

Different evidence would be required to establish a case under these conflicting theories. Under the “agreed to be paid” theory the evidence must establish that the trick or device consisted of a misrepresentation in respect to monies “agreed to be paid”. Under the \$2,000.00 per “act” formula the trick or device need not be concerned with monies “agreed to be paid” for the penalty to be affixed. This point will be developed more fully later in this brief.

The defendants were further prejudiced with respect to trial procedure in facing the problem of selecting or waiving a jury. Considerations which would affect this decision would necessarily differ, dependent upon the remedy sought.

In the discussion thus far the problem has been considered strictly from the point of view of election of remedies. It is suggested, however, that a deeper and more restrictive doctrine is also involved in the provisions of the War Surplus Act, namely, the doctrine of election of *rights*, as distinguished from, or in addition to, *remedies*.

By the provisions of the War Surplus Act the Government is given the right to one of the following:

- (a) \$2,000.00 per act;
- (b) double the consideration agreed to be given;
- (c) the return of the property.

The cases which discuss the doctrine of election of rights hold unequivocally that the election of one right of necessity operates to forego the other alternatives.

In *Schenck v. State Line Tel. Co.*, 238 N.Y. 308, 144 N.E. 592, at 593 the Court states:

“An election of remedies presupposes a right to elect (citing cases). It is ‘simply what its name imports; a choice, shown by an overt act, between two inconsistent rights, either of which may be asserted at the will of the chooser alone.’”

\* \* \* \* \*

“Often what is spoken of in opinions as a choice between remedies is in reality a choice of ‘an alternative substantive right.’”

The above case is the subject of an annotation appearing in 35 A.L.R. 1153, wherein it is stated, at page 1153:

“The rule as to election of remedies is not one of substantive law, but it is merely of judicial administration; and it is often confused with the question of the election of substantive rights. There is a clear distinction between the two. The doctrine of election of remedies applies in

order to protect one from vexatious litigation; while the rule as to election of substantive rights has to do with the actual status of some property or contractual rights. That is to say, a person having the option definitely to fix a property or contractual right without reference to the consent or wishes of the other party to the transaction is bound by his exercise of the option. This may be illustrated by reference to the right of a defrauded party to ratify and validate the contract, or the election of a seller to treat the title of goods as passed to the buyer, notwithstanding the latter's failure to perform a condition precedent. In such cases, by the exercise of his election, the party has definitely established the status of the right; and where he has acted with full knowledge of the facts, his act is properly irrevocable."

In the opinion on *Fire Protection Co. v. Hawkeye Tire & Rubber Co.*, 8 F. 2d 810 (8th C.C.A., 1926) the Court at pages 812-813 states:

"By the contract of sale the protection company, upon default in the payment of the purchase price, had the right to exercise its option to retain title, store and remove the sprinkler system, or to renounce its claim of title and enforce the collection of the purchase price. It had no option or right to do both, and a renunciation of its claim of title and right of removal and its election to enforce collection of the purchase price by filing its claim for its mechanic's lien, by filing its counter-claim for the purchase price and its cross-petition for the enforcement of its mechanic's lien in the state

court, was an irrevocable exercise of its option. The choice it reserved was not a choice of inconsistent remedies merely; it was a choice of contrary rights, of the right to title and possession of the sprinkler system and the right to the purchase price of it, rights which could not exist and be enforced at the same time; . . . *Van Winkle v. Crowell*, 146 U. S. 42, 13 S. Ct. 18, 36 L. Ed. 880; *Robb v. Vos*, 155 U. S. 13, 40, 43, 15 S. Ct. 4, 39 L. Ed. 52; *United States v. Oregon Lumber Co.*, 260 U. S. 290, 295, 43 S. Ct. 100, 67 L. Ed. 261; *Richards v. Schreiber*, 98 Iowa 422, 67 N.W. 569; *Kearney Elevator Co. v. Union Pacific Ry. Co.*, 97 Iowa 719, 66 N.W. 1059, 59 Am. St. Rep. 424. . . .”

And in *Boeing Airplane Co. v. Aeronautical Industrial District, etc.*, 91 F.S. 596 (1950), affirmed 188 F. 2d 357, certiorari denied, 342 U.S. 821, 96 L. Ed. 621, at page 613 it was said:

“‘Election is simply what the term imports — a choice shown by an overt act between two or more inconsistent rights, either of which may be asserted at the will of the chooser alone.’ 18 Am. Jur. 129, Election of Remedies, § 3. ‘Often what is spoken of in judicial opinions as a choice between remedies is in reality a choice of alternative substantive rights. The distinction is one not infrequently obscured, and yet it is important that it is heeded. . . . The doctrine of election of remedies applies in order to protect one from vexatious litigation, while the rule as to the election of substantive rights has to do with the actual status of some property or contractual rights. That is to say, a

*person having the option to fix definitely a property or contractual right without reference to the consent or wishes of the other party to the transaction is bound by his exercise of the option. . . .* ' (Emphasis added.)

\* \* \* \* \*

"We hold that the letter of April 22, 1948, manifested the intention of the plaintiff to rescind and was the acceptance by it of the choice between contract and no contract, a choice between substantive right or no right. The letter therefore constituted a final election to rescind."

Once the Government selected its substantive right that selection in itself eliminated its right at a later date to assume a position inconsistent with its former selection.

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### POINT 3.

**IF THE FILING OF THE ACTION DID NOT CONSTITUTE AN ELECTION THE PLAINTIFF WAIVED THE RIGHT TO CHANGE THE FORM OF ACTION.**

#### **A. By Filing the Second Amended Complaint.**

If the filing of the action did not constitute an election the plaintiff waived the right to change the form of action by filing the Second Amended Complaint.

4 C.J.S. 622 states:

"The subsequent amendment of a pleading usually waives the right to appeal from a judgment or order sustaining a demurrer to a former pleading, or from a ruling on a motion to strike or make more specific . . ."



The record in this case shows that the plaintiff voluntarily proceeded to trial upon the Second Amended Complaint. It should not be allowed at this late date to gamble on the outcome of the proceeding and retract its position because it became disappointed over the outcome.

**B. By Voluntarily Withdrawing the First Amended Complaint.**

Not only did plaintiff voluntarily proceed to trial upon the Second Amended Complaint, it voluntarily withdrew the First Amended Complaint. The Memorandum Opinion of Judge Jertberg summarizes the record in this respect as follows:

“The motion of the plaintiff to file the second amended complaint *and to withdraw the proposed first amended complaint is granted.*” (54)

**C. By Proceeding to Judgment.**

Plaintiff further waived the right to complain by proceeding to judgment.

4 C.J.S. 625 states:

“The right to appeal or bring error from an interlocutory order or decree will be regarded as waived where the party having such right voluntarily proceeds with, or participates in, subsequent steps in the trial, if this is inconsistent with the appeal or proceeding in error.”

Thus the right to appeal upon this point has been held waived by proceeding with the trial without first preserving it in the record.

## POINT 4.

**THE GOVERNMENT IS ESTOPPED BECAUSE DEFENDANTS  
HAVE SUFFERED PREJUDICE.**

The Government is estopped.

31 C.J.S. 417 states:

“The public, in the exercise of a proprietary, as distinguished from a governmental function, may be estopped by the acts or omissions of its officers acting within the scope of their lawful authority.”

The United States is not ordinarily estopped by acts done *in pais*, by its officers or representatives, but, when once in court, may be estopped of record by its attorneys and officers therein representing it.

*First Nat. Bank v. U.S.*, D.C., Mo., 2 F. Supp. 107.

These defendants proceeded to trial upon the theory that the penalty sought was \$2,000.00 an item. No particular stress was laid upon the dollar amounts involved, because that feature of the case was not before the Court. For that reason the foundation was waived in respect to practically every voucher, and no audit of any kind was undertaken or requested, to verify the accuracy and number of the same. Had a different form of relief been prayed for, defendants would have been forced to try the case upon an entirely different approach. Also, previously mentioned, is the jury problem.

It is readily ascertainable, therefore, that defendants would suffer great prejudice if this record at this time were looked at from a point of view of as-

certaining a recovery upon the theory of double the consideration involved.

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POINT 5.

**THE CAUSE OF ACTION SET OUT IN THE FIRST AMENDED COMPLAINT IS BARRED BY THE STATUTE OF LIMITATIONS —HENCE NO PREJUDICE.**

It is to be noted that the First Amended Complaint seeks relief entirely different from and inconsistent with that sought in the original Complaint. Paragraph VIII of the original Complaint (9 and 10) pleaded \$2,000.00 per act, only. The companion paragraph of the First Amended Complaint (32) requested a sum twice the consideration agreed to be given the United States. The prayer of the original Complaint was for the sum of \$2,000.00 per act, a total of \$336,000.00 damages (23). The prayer of the First Amended Complaint was for "a sum equal to twice the consideration agreed to be given to the United States" (42).

Not only was the theory of the First Amended Complaint different from the theory of the original Complaint, but the facts upon which the relief was sought differed, in that the original Complaint alleged a false statement to the effect that the property was purchased for personal use only, and the First Amended Complaint alleged a false statement that the veteran owned more than 50% of the capital invested in an enterprise, or was entitled to more than 50% of the profits emanating therefrom, and thus secured a permit to purchase for resale.

The original Complaint was filed December 31, 1954 (23). The proposed First Amended Complaint was first submitted by motion upon November 13, 1956, almost two years later. The Statute of Limitations barred the action December 31, 1954, under defendants' theory, and certainly by November 13, 1956, under any theory of computation of time.

The First Amended Complaint being inconsistent in theory and based upon a wholly different set of facts could not be so similar in nature as to date back in time to the filing of the original Complaint for the purpose of applying the Statute of Limitations under Federal Rules of Civil Procedure, Section 15(c). A complete argument upon this point is set forth in Appellant's Opening Brief in our own Appeal and will not be repeated here.

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#### POINT 6.

#### **PLAINTIFF COULD NOT RECOVER UNDER THE FACTS PLEADED AND PROVEN UPON THE PRAYER OF THE FIRST AMENDED COMPLAINT.**

The Surplus Property Act reads:

“shall, if the Government so elects, pay to the United States as liquidated damages a sum equal to twice the consideration *agreed to be given* by such person to the United States.”

There never was any money “agreed to be given” alleged in the Complaint. The transactions alleged were not executory but without exception were cash sales upon the spot. At no time was there any agree-

ment to *give* any sum in existence, and by no stretch of the imagination was any sum "agreed to be given" alleged in the Complaint.

The monies involved in this case were cash payments in consideration for the transfer of title to surplus property. It is conceivable that this section might be applicable to a case where, for instance, a bribe was involved or an executory contract fraudulently altered, but by no stretch of the imagination could it apply to a transaction of this character where no trick or device involving monies "agreed to be given" is pleaded.

The statute is entitled to a fair and reasonable construction and a strict construction against the Government where penal sanctions, whether civil or criminal in character, are involved.

50 *Am. Jur.* 432;

*Rainwater v. United States*, 78 Sup. Ct. Rep. 946.

To hold that the Government should be entitled to invoke twice the consideration agreed to be paid fails to give effect to the plain language of the Act. The Government is contending that the Act reads "to recover twice the monies *paid*", not "agreed to be given". This language does not appear in the Act. The consequences of such a construction are that monetary awards in favor of the Government are the sole objective of the Act, and not the honest administration of the disposition of surplus property. A violation of a minor regulation or of questionable character, or of a very slight nature, in a transaction



involving a large amount of money honestly and fairly paid and resulting in no monetary damage to the Government of any kind or character, could thus be catapulted into a triple recovery by the Government.

Furthermore, the Act as written, if so construed, is so ambiguous that it cannot be ascertained whether or not the Government in claiming double the amount agreed to be paid should not be required to allow the monies received as a credit.

50 *Am. Jur.* at page 383 states:

“It is to be presumed that the legislature did not intend a law to work a hardship or an oppressive result, and it is a general rule that where a statute is ambiguous in terms and fairly susceptible of two constructions, the hardship which may follow one construction or the other may properly be considered.”

And, further:

“A construction should be avoided which would render the statute productive of unnecessary hardship, harsh or harmful consequences, or oppression, or arm one person with a weapon to impose hardships on another.”

The Government may not argue that a strict construction imposes a hardship upon it. A literal construction of the language of the statute is all that defendants urge.

50 *Am. Jur.* 385 states:

“A court may not extend a statute, or construe it otherwise than as written, to avoid a hardship. If the law as written works a hardship in a spe-

cial class of cases, the remedy is to be effected by the legislature, and not by judicial action in the guise of interpretation. Hence, where the language of a statute is clear and unambiguous and the intention plain, it is the duty of the court to expound the statute as it stands."

Here the language of the statute is plain. It does not cover transactions that are *not* executory and do not involve monies that are not "agreed to be given".

In *U. S. v. Katz*, 90 Law. Ed. 988 (1925), Justice Stone states:

"All laws are to be given a sensible construction, and a literal application of a statute which would lead to absurd consequences should be avoided whenever a reasonable application can be given it consistent with the legislative purpose."

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#### POINT 7.

**THE TRIAL COURT HAS FOUND UPON THE EVIDENCE THAT THE TRICK OR DEVICE HERE INVOLVED DID NOT EMBRACE "MONIES AGREED TO BE GIVEN".**

The trial court specifically found that the transactions of all defendants did not involve a trick or device in which monies were "agreed to be given" (Finding IV, 108). In reference to Hougham and Dailey the Court found the act to be the presentation to the War Assets Administration of a Veteran's Application for Surplus Property in the name of Owen Dailey, Case No. V10A 55767, dated June 29, 1946, and the act of Hougham and Schwartz to be the presentation to the War Assets Administration of

his Application (Finding VIII, 111), and the act in respect to Hougham and McFarland to be the presentation of two Applications to the War Assets Administration (Finding XII, 114). It found that the *trick* did not involve monies "agreed to be given".

In other words, the Court specifically found that the trick or device embraced the acquisition, and not the use, of the applications, in each instance. This is tantamount to a direct finding against a trick or device involving monies. The Government received full payment for the merchandise it sold, and it follows that there was no fraudulent trick or device involving monies. The authorities are clear that where the trick or device used does not involve a monetary fraud the mere fact that monies are eventually paid does not make a scheme a monetary fraud. The authorities have long supported this view.

The leading case upon the subject is *U. S. v. Hess*, 87 Law. Ed. 443. There open bidding was required on WPA projects and certain contractors conspired to prevent competitive bidding, as a result of which 57 WPA projects were contracted for. Under these projects thousands of individual items of property and payments of money were involved. The Government contended that the \$2,000.00 penalty applied to each of the thousands of items. The Court held that there was one conspiracy only in reference to each WPA project and allowed a recovery upon the basis of 57 projects.

In *U. S. v. Rohleacher*, 157 Fed. Supp. 126, there were considered 8 main contracts, under which 96 pur-

chase orders were involved. The Government contended for the \$2,000.00 penalty on each of the 96 purchase orders. The Court limited the recovery to the 8 main contracts only.

In *U. S. v. Grannis*, 172 Fed. 2d 507, 10 vouchers involving fictitious claims for rental of 130 cars were involved. The Government contended that there were 140 violations, e.g., the 10 vouchers plus the 130 units, and claimed damages in the amount of \$280,000.00. The recovery was limited to 10 violations, and \$20,000.00 only was allowed. (Certiorari denied by Supreme Court.)

In *First National Bank of Birmingham v. U. S.*, 117 Fed. 486, the Bank sued for \$12,000.00 due upon a Government contract assigned to it. In offset to this demand the Government claimed \$2,000.00 per voucher on 13 vouchers, each of which were fraudulent claims since they were demands for work not performed. The Government was allowed the offset because each voucher was tainted with a separate fraudulent claim.

In *U.S. v. American Parking Car*, 125 Fed. Supp. 788, vouchers for payment were submitted containing separate false statements. Held a separate act for each separate false statement.

In *Rex Trailer Co. v. U. S.* (1956), 100 Law. Ed. 160, 5 trucks were purchased through schemes involving 5 separate veterans.

The recovery of \$2,000.00 for each act was allowed upon the theory that the fraudulent use of each vet-

eran's name constituted one transaction. It is true that the cases cited deal with the application of the so-called "False Claims Act" and not the "Surplus Property Act". The question involved, however, is identical in both Acts because they both contain the identical civil penalty clause, and both Acts necessarily leave to the trier of fact the right to define the extent and character and breadth of the trick, scheme or device, dependent upon the particular circumstances of each case.

The cases cited hold it to be a question of fact for the Trial Court to determine, and this being the case the question may not be presented to an appellate court for review as a question of law alone where substantial evidence supports the theory of the trier of fact.

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### CONCLUSION.

It is respectfully submitted that, in the event that the appeal of these defendants be denied, the judgment be affirmed in its present form:

1. Because the Government has failed to preserve its point in the Trial Court;
2. It elected its form of remedy by filing the action;
3. It waived its right to elect at a later date by withdrawing the proposed amendment, substituting a different amendment, and proceeding to trial and judgment; and



4. In any event no prejudice to the Government resulted from the alleged ruling of the Trial Court below because:

(a) The action is barred by the Statute of Limitations;

(b) The Government would be entitled to no relief under the facts pleaded upon the prayer of the First Amended Complaint because they did not involve monies "agreed to be given"; and

(c) The scope and breadth of the trick or device has already been presented to the Trial Court and found to be adverse to the position of the Government.

Dated, Bakersfield, California,  
July 15, 1958.

Respectfully submitted,

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No. 15,873

United States Court of Appeals  
For the Ninth Circuit

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E. B. HOUGHAM, OWEN DAILEY, WILLIAM E.  
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Honorable Gilbert H. Jertberg, Judge.

APPELLANTS' CLOSING BRIEF.

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FILED

AUG - 4 1958

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**POINT 1.**

**THE EVIDENCE IS INSUFFICIENT TO SUPPORT  
THE FINDING OF FRAUD.**

In Appellants' Opening Brief the point was made that the evidence was insufficient to support a finding of trick or device for the reason that no veteran made a material misrepresentation in securing his priority certificate. Appellee has failed to answer this contention.

The Government advances the theory that there was a misrepresentation in respect to the enterprise.

It argues (Appellee's Brief, p. 3) "Each of these applications described an established business." The record does not bear out this assertion. Dailey described his enterprise as "wholesaler-retailer" [127]; Schwartz as "truck rental" and "It is already established? Yes", "If yes, are you operating it? No"; and, further, "I planned to start with the surplus units I obtained."; "Size of enterprise? ..... " [207]. McFarland stated "auto dealer" [219] on the second application, and "truck sales and service" on the first [227]. In no case was there a description of any business given. Had there been a misrepresentation as to the nature, size, character or extent of the undertaking there would be a basis to argue that there was a trick or device. The fact of the matter is that during the period involved in these transactions the policy of the War Assets Board was not to inquire into the nature, extent, character or size of any particular undertaking. This policy was not adopted until November of 1946, long after all of the applications were signed and after all of the purchases were made.

Dailey, McFarland and Schwartz were in a literal sense automobile dealers, because they had *bona fide* qualified to engage in such business under the laws of California, which required a Dealer's license. The transactions in question, without exception, are the result of engaging in the business of automobile dealing. The term does not imply an undertaking of any particular size or specific character. The re-

marks with respect to the nature of the business of the veterans contained in the certificates are not false in any material respect. The Court below fell into the error of assuming that the enterprise of being an automobile dealer required some undisclosed degree of substance. This would be true if, and only if, an inquiry was made in that respect and a concealment of the character or status of the enterprise was given in response.

The important point is that there was a full disclosure by each veteran of the intended purpose of the purchase. In McFarland and Dailey's case there was a full disclosure of an intent to resell. In the case of Schwartze there was a disclosure of an intent to form a truck rental service, which plan was frustrated.

That the Court below fell into this error is demonstrated by the statement: "from all of the evidence that as far as any enterprise of these men, it was purely synthetic" [443]. That is the entire basis of the Court's decision. The Court did not find that there was a misrepresentation by which any advantage of the Government was taken. On the contrary, the Court concluded: "Now, I don't say at all that there was anything sinister or evil in the arrangement that had been made. I think that Mr. Hougham was anxious to give some help to those veterans. I don't feel that he had figured out in his mind, in detail, 'I will work it this way and in that way get around the law'. I don't know how familiar he was

with the regulations, but, of course, lack of knowledge of the regulations, under the law, is not a defense in the action.” [443-444]<sup>1</sup>

It was pointed out in the Opening Brief that there was no regulation in effect during the period in question prohibiting a resale by the veteran to any person whom he chose, or from buying surplus property from the Government with borrowed money. The underlying defect in the Court’s decision on the merits is failure to clearly distinguish, in its own mind, between the present case and the type of case, both civil and criminal, known as “The Veteran Front Case”. In those cases veterans have purchased certain kinds of scarce articles, such as trucks, which War Assets had set aside for the sole use of veterans. It attained its end by forbidding resale and requiring the veteran to sign a statement to the effect that it was for his own use only and not for the use of any other merchant or undisclosed partner or principal. Typical of the veteran front cases are *Rex Trailer v. U.S.*, 350 U.S. 148; *Daniel v. U.S.*, 234 F. 2d 102, and *U.S. v. Comstock Mining Extension Co.*, 214 F. 2d 400. Those cases are distinguished from

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<sup>1</sup>§ 8302.9(b), page 2070, U.S. Code Congressional Service, 79th Congress, 2nd Session, provides:

“(b) *Except in the case of transfers to Reconstruction Finance Corporation as successor to Smaller War Plants Corporation for resale under section 18(e) of the Surplus Property Act of 1944, and disposals to veterans of property to be resold with or without processing or fabrication in the regular course of business, transfers or disposals to priority claimants shall be for their own use only and not for transfer or disposition by them to others, and disposal agencies may require priority claimants so to certify.*” (Emphasis added.)



the case at bar in that there, deliberate false misrepresentations that the article was purchased for personal use were made, and immediately after acquisition the articles were transferred to non-veterans, with the result that articles in short supply, limited to veterans for personal use, were illegally siphoned off into prohibited channels. The articles here involved were not sold to the veterans under conditions restricting their use to personal use. They were sold to the veterans after a complete disclosure that the articles were intended for resale. They were not considered articles in "short supply" at the time of these transactions, but were articles specifically offered for sale by the War Assets Administration, knowing that they were intended for resale. There was no sinister result achieved by the operations of these defendants. The only result achieved was that articles of merchandise were offered for sale to veterans for unrestricted resale, and these veterans, in a legal manner, acquired funds for the purchases. At this point the Government had achieved everything bargained for, had lost all title to the merchandise upon receipt of the price, and had no further legitimate interest in the merchandise or any further right to restrict its use or to designate the channels of trade in which it could operate. Assuming that the War Assets Administration could have restricted the intended use at the time of the sale, the fact is that here it did not, and its reason for not doing so was not due to any trick, device or concealment of any kind by any of these defendants. If any such restriction on the right of resale was intended it could



easily and distinctly have been written into the regulations and certificates in such a way as to clearly draw the line between lawful and unlawful conduct and advise the veteran how to avoid an unlawful act. As the Supreme Court said in *Krause & Bros. v. U.S.*, 327 U.S. 614, 621, 90 L. ed. 894, 898, involving an alleged evasion of price regulations:

“ . . . ; they must adequately inform those who are subject to their terms what conduct will be considered evasive so as to bring the criminal penalties of the Act into operation. See *United States v. Wiltberger*, 5 Wheat. (U.S.) 76, 94-95, 5 L. ed. 37, 42, 43. The dividing line between unlawful evasion and lawful action cannot be left to conjecture. The elements of evasive conduct should be so clearly expressed by the Administrator that the ordinary person can know in advance how to avoid an unlawful course of action.”

This Court has overlooked as applicable to this case the fundamental rule of law which prescribes that there can be no fraud or deceit unless the representee is deceived. *Ming v. Woolfolk*, 116 U.S. 599, 29 L. Ed. 740; *Stratton Independent v. Dings*, 126 F. 968, 977. Under the facts proven there is no occasion to indulge in the sinister fiction that these defendants were mere “messenger boys” of Hougham.

In *U.S. v. California Midway Oil Company*, 259 F. 343, where the Government challenged oil locations on the ground that the entries had been made by dummies the Court states:

“If the circumstances proven are just as consistent with honesty and good faith as with a

fraudulent intent, the inference of fraud is not warranted. In short, when two inferences can be drawn from proven facts, one in favor of fair dealing and good faith and the other of corrupt motive, it is the duty of the trier of fact to draw the inference favorable to good faith and fair dealing. In re: Hawks, 204 Fed. 316; *Ryder v. Bamberger*, 172 Cal. 797, 158 Pac. 753."

There never had been a "veteran front" case involving a certificate issued authorizing the veteran to resell prior to *Bernstein v. U.S.*, appended to the Government's Appeal Brief. That case is distinguishable upon the facts in several important particulars. First, in respect to the policy of the War Assets Administration, in the instant case the applications were made and signed at a time when the policy of the Board was not concerned with the details of or the nature or extent of the enterprise. The transactions here involved took place between March and September, 1946, and the applications themselves, made in March and July, 1946, show that no information was inquired of the veteran in respect to the nature, character, extent or size of the enterprise. In this regard all of the applications are blank.

In November of 1946 the policy of the War Assets Administration changed and more detailed information was requested of veterans proposing to acquire property for resale. This was pointed out in Appellants' Opening Brief and is forcefully shown in the *Bernstein Veteran's Application*, which was not prepared until November 19, 1946.

There Bensik, the veteran, was required to certify: "That I am or have made necessary arrangements to become an established dealer, jobber or distributor of the kind that customarily take into their possession, and have full control for the purpose of reselling, property of the kind covered by this order; that I am not a broker and will not use the property ordered to operate as a broker whose business it is to bring buyers and sellers together and who does not normally take title to or possession of property and is generally an agent of one of the parties to a sale; that I will not indulge in 'drop sale' disposal of the property ordered. I further certify that I now have or will make definite arrangements for a suitable office and operating and storage space, and that I am sufficiently financed to enable me to conduct my business of the kind above stated."<sup>2</sup>

After such a certification Bensik was charged with a false representation that he was not the broker or agent of Bernstein.

No certification was required of these defendants of anything like that character. Only in the case of Owen Dailey was there any certification in any way approaching the Bensik certification, and he certified "I am not purchasing the property described herein for the benefit of any other enterprise, dealer, broker, merchant or other undisclosed partner or principal." This certification was true and not in any way false

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<sup>2</sup>Taken from Appellant's and Cross-Appellee's Brief, Bernstein Appendix, Bernstein v. U.S., No. 5704, U.S. Court of Appeals, 10th Circuit.

because Dailey himself benefited and he did not certify that no other person would not also ultimately benefit. The question of how far the Government may control property after authorizing it to be resold is squarely raised in the *Bernstein* case by the change in the policy of the War Assets Administration. The certification required by the War Assets Administration in the *Bernstein* case was not authorized by any provision of the War Surplus Act or any regulation issued pursuant thereto, and its right to require a dealer to restrict his trade to certain classes of customers by excluding others is subject to challenge as being void for the reason that it is contrary to the provisions of the War Surplus Property Act and the regulations.

*Peo. v. Finn Twins*, 127 Fed. Supp. 158.

This feature of the *Bernstein* case is not presented in this record, for it was not a part of the policy of the War Assets Administration at the time of these transactions, and these veterans were not required to certify that they would not resell to brokers, etc. This distinction purges the conduct here relied upon by the Government as a badge of fraud. (Respondent's Brief, pages 12 and 13.)

The purchase of large amounts of surplus property by impecunious veterans is of no consequence if no false representation was made. Similarly, it is of no consequence if the purchase was made by money supplied by Hougham, if the transaction was not connected with a false representation. Also, Hougham's failure to charge interest and the informality of the



records of the loans loses insignificance as does the price received by the veteran. These circumstances, coupled with a false statement, we would admit to be ample evidence of a badge of fraud. Standing alone, however, there is nothing wrong or improper about any act in itself.

We are mindful of the rule that this Court will not ordinarily reverse unless the finding of the Trial Court is "clearly erroneous," but we submit that this ruling is "clearly erroneous" and that the District Court's Findings will leave this Court with a "definite and firm conviction that a mistake has been committed."

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POINT 2.

**THE ACTION IS BARRED BY THE  
STATUTE OF LIMITATIONS.**

The Government suggests that the case of *Rex Trailer Co. v. United States*, 350 U.S. 149, has a bearing on this problem. This contention is unsound. The *Rex Trailer* case has no bearing whatsoever upon the question of whether the statute of limitations applies to a case of this character. There the question was whether or not the provisions of Section 26 (b) (1) were afforded a criminal penalty or a civil penalty. The Court states:

"Petitioner's sole contention is that §26 (b) (1) provides a criminal penalty and, having once been convicted and fined for the transactions in question, it cannot again be subjected to punishment. The only question for our decision, then,



is whether §26 (b) (1) is civil or penal, for 'Congress may impose both a criminal and civil sanction in respect to the same act or omission; for the double jeopardy clause prohibits merely punishing twice, or attempting a second time to punish criminally, for the same offense.' We conclude that the recovery here is civil in nature."

It relies upon *Marcus v. Hess*, 317 U.S. 537, a False Claims case containing a provision for \$2,000.00 plus double damages, which clearly recognizes the rule that an action may be civil in nature and yet enforce a "civil fine, penalty or forfeiture, pecuniary or otherwise." In that case the precise question involved was "Is the action now before us, consisting of double damages and the \$2,000.00 forfeiture, criminal or civil? It is enough for present purposes if we conclude that the instant proceedings are remedial and impose a civil sanction."

And, further:

"Quite aside from its interest as preserver of the peace, the government when spending its money has the same interest in protecting itself from fraudulent practices as it has in protecting any citizen from frauds which may be practiced upon him. 'The powers of the United States as a sovereign, dealing with offenders against their laws, must not be confounded with their rights as a body politic. It would present a strange anomaly, indeed, if, having the power to make contracts and hold property as other persons, natural or artificial, they were not entitled to the same remedies for their protection.' "

And:

“It is argued that the \$2,000 ‘forfeit and pay’ provision is ‘criminal’ rather than ‘civil’ even if the double damage feature is not. The words ‘forfeit and pay’ relate alike to the \$2,000 sum and the double damages. The use of the word ‘forfeit’ in conjunction with the word ‘pay’ does not force the conclusion that the provision is criminal. No one doubts that Congress could have accomplished the same result by authorizing ‘double’ or ‘quadruple’ or ‘punitive’ damages or a lump sum payment for attorney’s fees, or by definition of the elements of ‘actual damages.’ Special consequences cannot be drawn from the use of the word ‘forfeit.’ While this might under other circumstances be an appropriate word to suggest a fine upon the failure to pay which an individual might be imprisoned, no such punishment is provided here upon default in payment. The words ‘forfeit and pay’ are wholly consistent with a civil action for damages.”

By relying upon *Marcus v. Hess* as its authority, the *Rex Trailer* case in fact aligns itself with the reasoning of the majority of the Circuits relied upon by these defendants.

Furthermore, it should not be overlooked that the Government does not rely upon the *Rex Trailer* case itself but cites a “footnote” as its authority. The footnote is nothing more than a casual observation. It is not a part of the opinion and is an inaccurate expression of the fact in stating “The Sixth Circuit held it to be penal in *United States v. Witherspoon*, 211 F. 2d 858.” The precise statement is that 28

U.S.C.A. §2462 applies to a War Surplus act involving a \$2,000.00 civil penalty for each act. There the Court stated:

“We are of the opinion that the action is one for penalties. A statute is penal where the purpose is to punish an offense against the public justice, as distinguished from an action affording a private remedy for injury by a wrongful act; the word, ‘penalty,’ strictly and primarily denotes punishment, imposed and enforced by the state, for an offense against its laws. It also *commonly is used as including any extraordinary liability to which the law subjects a wrongdoer in favor of the person wronged, not limited to the damages suffered.*”

And, further:

“‘The term “penalty” is commonly used in the sense of an extraordinary liability to which the law subjects a wrongdoer in favor of the person wronged as distinguished from compensation for the loss suffered by the injured person.’ ”

Further:

“The exaction of the arbitrary sum of \$2,000 for each offense of obtaining, by fraud, surplus property, without regard to its value, is a provision for a penalty.”

The case of *United States v. Doman*, decided by the Third Circuit and reported in the Appendix to the Government’s Brief, is based upon faulty reasoning throughout. First, it uses the “boot strap” argument and cites the Memorandum Opinion of Judge Jertrberg as its authority. Thus this Court is asked

to bow to the will of the Trial Court. The *Rex Trailer* case is improperly relied upon, for it is quoted as authority for a proposition which was never before it and which it expressly left open.

It relies upon *Marcus v. Hess*, which also leaves open the specific point here involved, and which, as previously demonstrated, recognizes that there is such a thing commonly known to the law as "civil penalties".

Its premise that §26 (b), containing three subdivisions, should be construed *in pari materia* adds no substance to its position. Of course they are compensatory. All three subdivisions are compensatory, but even though compensatory they are in the nature of a fine, penalty or forfeiture.

The reasoning of the *Weaver* case and all others adopting the minority view is faulty in that it deliberately closes its eyes, like an ostrich with its head in the sand, to the plain meaning of the language of the Act, and deliberately distorts the same, while the reasoning of the majority of Circuits is in line with sound legal reasoning and a reasonable construction of the language of the statute.

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#### CONCLUSION.

We sincerely believe that we have demonstrated conclusively to this Court that the finding of fraud by the Trial Court is clearly erroneous. We note that the Government admits a complete failure of

the Trial Court to find upon a material issue, and we earnestly request this Court, if necessary, to align itself with the better reasoned Circuits in respect to the Statute of Limitations.

Dated, Bakersfield, California,  
July 29, 1958.

Respectfully submitted,

CONRON, HEARD & JAMES,

By CALVIN H. CONRON, JR.,

*Attorneys for Appellants.*





No. 15,873

United States Court of Appeals  
For the Ninth Circuit

---

UNITED STATES,

*Appellant,*

VS.

E. B. HOUGHAM, et al.,

*Appellees.*

On Appeal from the United States District Court for  
the Southern District of California,  
Northern Division.

REPLY TO PETITION FOR REHEARING.

---

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FILED

MAY - 11 - 1933

PAUL P. HENRY - A. ELLIS



No. 15,873

**United States Court of Appeals  
For the Ninth Circuit**

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UNITED STATES,

vs.

E. B. HOUGHAM, et al.,

*Appellant,*

*Appellees.*

On Appeal from the United States District Court for  
the Southern District of California,  
Northern Division.

**REPLY TO PETITION FOR REHEARING.**

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*To the Honorable Chief Judge, and to the Honorable  
Associate Judges of the United States Court of  
Appeals for the Ninth Circuit:*

We respectfully suggest that the Petition for Rehearing of Appellant should be denied. The opinion is not based upon a ground which was neither briefed nor argued by either party; on the contrary, the position of the Government is argued on page 15 of its brief and again on page 20, and the Court adopted the theory of Appellant in its opinion, where the Court states:

“The amount of recovery prayed for had no effect upon the substance of the claim. If a cause of action was stated, based upon the statute, the

amount of recovery would be based upon the proof.

and

“At the end of the trial the Government would be entitled to that which the Court found was established by the evidence.”

Appellees argued the matter from the premise that an election was improper and not applicable in its brief on pages 23 through 26 inclusive, and pointed out that under the allegations of the First Amended Complaint, and under the proof submitted at the trial, there was no proof of, “Twice the consideration agreed to be given by such person to the United States.”

The opinion supports the trial Court’s version that the evidence offered did not support a recovery under the second alternative of the Act. It follows that the major premise and the entire Petition must fall, because the Court is making no selection or election of remedies to the exclusion of the Government. The Court has merely found that the Government has failed to present a case which would justify a recovery under the second alternative.

It is submitted that the Supreme Court’s denial of certiorari in the case of *Koller v. U. S.* in no way effects the reasoning of the Court that a choice of remedies willy nilly, regardless of the evidence, would provide a criminal penalty. The comments of the Court in this regard are not germane to the basis of the opinion which rejected the statute of limitations argument.



The opinion does not state, as the Petition suggests, that the conclusion of the Court was in any way effected by the fact that no actual damages were proven, nor does it follow that to admit some theoretical rather than monetary damage, would in any way change the result. The reasoning of the Government on page 9 of its Petition is entirely fallacious for the Surplus Properties Act allows sales, not only for cash, but on credit, on bids, on contract, and on numerous situations where the transaction at some time or stage had an executory covenant where a sum of money was agreed to be paid. At any rate, had Congress intended to achieve the result sought by the Government, it could have done so by appropriate language.

Dated, Bakersfield, California,

May 6, 1959.

Respectfully submitted,

CONRON, HEARD & JAMES,

By CALVIN H. CONRON, JR.,

*Attorneys for Appellees.*



No. 15886 ✓

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**United States  
Court of Appeals**  
for the Ninth Circuit

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DIXIE TANK & BRIDGE CO., a Corporation,  
Appellant,

vs.

COUNTY OF ORANGE, a County of the State of  
California, and WILLIS H. WARNER,  
Appellees.

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**Transcript of Record**

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**Appeal from the United States District Court for the  
Southern District of California  
Central Division**

**FILED**

AUG - 4 1958



No. 15886

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**United States  
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Southern District of California  
Central Division**





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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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In the United States District Court, for the Southern District of California, Central Division

No. 597-57 Y

DIXIE TANK & BRIDGE CO., a Corporation,  
Plaintiff,

vs.

COUNTY OF ORANGE, a County of the State of California; and WILLIS H. WARNER,  
Defendants.

### COMPLAINT

(For Money, to Enforce Mechanic's Lien  
and Declaratory Relief)

Comes plaintiff above named and for cause of action against the defendants alleges:

#### I.

That jurisdiction of this action rests on Title 40, U.S. Code Sec. 1332, Subsection (a) (1).

#### II.

That at all times mentioned herein, plaintiff Dixie Tank & Bridge Co., was, and now is, a corporation duly organized and existing under and by virtue of the laws of the State of Tennessee, with its office and principal place of business at Memphis, Tennessee; and is a citizen of Tennessee. That at all times mentioned herein, plaintiff was, and now is,



a duly licensed general contractor under the laws of the State of California. [2\*]

### III.

That at all times mentioned herein, the defendant County of Orange was, and now is, duly established and organized as a County, under the laws of, and within, the State of California. That defendant Willis H. Warner, at all such times, was and now is the Chairman of the Board of Supervisors of said County. That both of said defendants are citizens of the State of California.

### IV.

That in the year 1956, plaintiff and the defendant County entered into three agreements in writing, whereby plaintiff agreed to furnish the material and labor necessary therefor, and to clean, paint and repair the 100,000 gallon elevated water tank of the defendant County, located at the Orange County General Hospital operated by the defendant County, and situated at or near the Town of Orange, within said County, upon the lands hereinafter described, and whereby the defendant County agreed to pay plaintiff therefor the total sum of \$7,511.60, upon completion of said work. That said work was reasonably and necessarily divided into two or more work projects and orders, because the necessary repairs to said tank, especially the amount of welding necessary to make the same water tight could not be determined until after the cleaning and

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\*Page numbering appearing at foot of page of original Certified Transcript of Record.

scaling thereof had been completed. That the separate work projects or orders involved therein, and the agreed price for each, were contracted for as follows:

(1) On August 28, 1956, the Board of Supervisors of said County unanimously authorized the Purchasing Agent of said County to arrange for the repair of said tank at an estimated cost of \$6,500.00 as provided in Requisition No. M2946A. The Purchasing Agent duly solicited bids from qualified contractors, including plaintiff, pursuant to this authority; and duly reported plaintiff's bid as the lowest received in response to such invitation.

(2) On October 2, 1956, the Board of Supervisors duly met [3] and unanimously authorized its Chairman aforesaid to sign for said County a contract with plaintiff obligating plaintiff to clean and paint said tank for a price of \$1,850.00, a copy of which is hereto attached, marked Exhibit "A" and incorporated herein in full by this reference; and pursuant thereto, said contract was thereupon duly signed by plaintiff and by the defendant County acting through said Chairman.

(3) On October 5, 1956, Erma Graham, Acting Purchasing Agent of said County, by authority of the Board of Supervisors, granted on August 28, 1956, as foresaid, issued to plaintiff the County's Order No. 62659, whereby (in addition to the cleaning and painting covered by the contract Exhibit "A" hereto) the County employed plaintiff to

tighten and adjust all loose sway rods and to replace catwalk plates where necessary, for a price of \$1,000.00, as a part of said work. That a copy of said Order No. 62659 is hereto attached, marked Exhibit "B" and incorporated herein in full by this reference. (The issuance of said work order was ratified by the Board of Supervisors on November 7, 1956, as next shown).

(4) Plaintiff duly cleaned the tank, which revealed that to render the tank water tight would require the welding of 3616 rusted out rivets and 712 lineal feet of seams, the price of which work, as set forth in plaintiff's bid aforesaid and in Order No. 62659 aforesaid, was 60c each for welding the rivets and \$3.50 per lineal foot for the seam welding, making the total price for welding of both rivets and seams \$4,661.60. On November 7, 1956, with knowledge of all the foregoing, the Board of Supervisors met and unanimously authorized the Purchasing Agent to spend \$1,011.60 additional to the \$6,500.00 authorized on August 28, 1956, to complete said work; and authorized its Chairman to enter into a contract with plaintiff for said welding, a copy of which is hereto attached, marked Exhibit "C" and incorporated herein in full by this reference, and pursuant to such authority, plaintiff, acting through its agent, [4] and the defendant County, acting through said Chairman, on November 7, 1956, signed said contract for said work. This contract (Exhibit "C"), together with the contracts set forth in Exhibits "A" and "B" hereto total \$7,511.60. [5]

5. On November 13, 1956, Courtney R. Chandler, purchasing agent of said County, issued to plaintiff a change order for \$1011.60 additional to the \$6500.00 estimate, pursuant to the aforesaid authorizations from the Board of Supervisors dated August 28, 1956 and November 7, 1956; and a copy of said change order is hereto attached, marked "Exhibit D" and incorporated herein in full by this reference.

That copies of the minutes of the Board of Supervisors relating to said work projects are consolidated into the paper which is attached hereto, marked "Exhibit E" and incorporated herein in full by this reference.

#### IV.

That plaintiff began the work called for by said written agreements aforesaid, on or about October 5, 1956, and completed the same on November 21, 1956, when the same was accepted and approved by the said County's agent and representative in charge of said work, and the plaintiff fully kept and performed all the terms and conditions thereof on its part to be performed, and has offered, and now offers, to issue its standard form of warranty and guarantee (provided for in clause 4 of the contract dated October 2, 1956) covering the maintenance of said tank for a period of twelve years from date, upon condition that defendant County pay its just claim for said work in the sum of \$7,511.60.

## V.

That on November 24, 1956, plaintiff filed with and presented to the Board of Supervisors of said County its claim for the \$7,511.60 due plaintiff as the total price of said three work projects, but said Board has failed and refused for more than ninety days since said date to approve said claim, and the same has been rejected in full by said Board, and no part of said sum has been paid to plaintiff.

## VI.

That as part of the aforesaid contracts between plaintiff [6] and defendant County dated October 2 and November 7, 1956, defendant Willis H. Warner covenanted with plaintiff that he was fully authorized and empowered to sign, execute and deliver said contracts to plaintiff on behalf of said County and that all legal requirements precedent thereto had been fully complied with, and plaintiff relied thereon.

## VII.

That plaintiff is informed and believes that one, more or all of said written agreements covering said work projects are claimed by the defendant County to be void and unenforceable on the alleged ground that they covered only one indivisible work project, and were not entered into pursuant to advertisement for bids, contrary to Sections 25450 and 25452 of the Government Code of California. Plaintiff is informed, believes, and respectfully represents that said written agreements were validly entered



into and are enforceable against said defendant County; and that to the extent, if any, that they may be not so enforceable, defendant Willis H. Warner is personally liable to plaintiff for breach of his aforesaid covenant.

### VIII.

That upon presentation of plaintiff's claim on November 24, 1956, the defendant County, acting by and through its Purchasing Agent, demanded of plaintiff that plaintiff itemize the cost to plaintiff of the material, supplies and labor used in performing said work, as a condition precedent to allowance of said claim by the Board of Supervisors, which demand is an unreasonable and unlawful requirement, as plaintiff is informed and believes and states.

### IX.

That the land upon said tank was so cleaned, repaired and painted under said agreements is described as follows, to wit:

A parcel of land situated in the County of Orange, State of California, known as the Orange County General Hospital Tract, formerly known as 12071 Santa Ana Boulevard, near the City of Orange, California, consisting of [7] about 10 acres, more or less, and occupied by the Orange County General Hospital, at the southwest corner of Placentia and West Chapman Streets.

That the whole thereof is required for the convenient use and occupation of said premises.

## X.

That at all times mentioned herein the defendant County was the owner and reputed owner of said land and of the buildings and the water tank erected thereon.

## XI.

That on February 7, 1957, plaintiff filed for record in the office of the County Recorder of said County of Orange, its claim and notice of lien in writing, duly verified, a copy of which is attached hereto, marked "Exhibit F" and made a part hereof; and which said claim and notice was thereafter on the same day duly recorded in said office in Book 3796, Page 334 of Official Records of Orange County, California. That plaintiff paid \$2.50 for verifying and recording said lien.

## Second Cause of Action

For a Further, Separate and Distinct Cause of Action,

Plaintiff incorporates herein, by this reference, all of the allegations of the First Cause of Action, *supra*, except paragraph III thereof, and in place and stead of said paragraph alleges:

## I.

That on and between October 2, 1956 and November 21, 1956, at the special instance and request of defendant County of Orange, and upon its promise to pay, made through its duly authorized representatives, to wit, the Board of Supervisors, the

Chairman of said Board, and the Purchasing Agent of said County, the reasonable value thereof, plaintiff furnished and performed work and labor and materials necessary for the cleaning, painting and repair of [8] the 100,000 gallon elevated water tank of the defendant County, situated on the premises known as the Orange County General Hospital Tract, which labor and material were furnished to be used, and were used, in said work; and that said labor and materials were of the reasonable worth and value of \$7,511.60, no part of which has been paid.

Wherefore, plaintiff demands judgment as follows:

1. Against the defendant County of Orange and the Defendant Willis H. Warner, in the sum of \$7,511.60, together with interest thereon at the rate of seven per cent per annum from November 24, 1956, and for plaintiff's costs, including reasonable attorney's fees, and the sum of \$2.50 for filing and recording the lien notice aforesaid; and that the premises hereinabove described may be sold and the proceeds thereof applied to the payment of said judgment, interest and costs.

2. That the Court decree and declare whether, and to what extent, if any, the written agreements for the work aforesaid are invalid under Sections 25450 and 25452 of the Government Code of the State of California, and whether defendant is required by Sections 29700 and/or 25458 to itemize its costs of labor and material as a condition precedent

to allowance of all or any part of plaintiff's claim by the Board of Supervisors of the defendant county; and

3. For all such other, further and different relief as the Court deems just in the premises.

/s/ JAMES C. R. McCALL,  
Attorney for Plaintiff. [9]

## EXHIBIT A

Form 4-C

Dixie Tank & Bridge Company  
Memphis, Tennessee

Contract for Cleaning, Scaling, Inspecting  
and Painting

This contract entered into for emergency repairs by and between Board of Trustees (Authorized Agent) County of Orange Hospital County Purchasing Department hereinafter known as First Party and the Dixie Tank & Bridge Company, Memphis, Tennessee, hereinafter known as the Company.

Witnesseth:

1. The Company agrees to do the following described work for First Party on its 100,000 gallon elevated water tank located at Orange, California, to wit:

1 a.—Company will rig, clean and scale the inside of the tank, so inspection can be made together

with the inspectors of First Party to determine what, if any, repairs are necessary, First Party shall furnish electric current to perform work. Company shall have the right to install outlets in the tank for ventilation and cleaning purposes at our prevailing prices.

1 b.—Company will furnish all labor and material to paint the interior of said tank with one (1) coat of Dixie Asphalt Tank Reliner. This paint will pass Federal Government Board of Health tests as being tasteless and non-poisonous, will expand and contract with heat or cold, will not chip, crack or peel, and will resist electrolysis, alkaline, iron or other minerals that are in the water. Water can be put in tank 24 hours after painting. The inside or under side of roof and spider rods are to be painted with exterior paint, one primer coat and one finish coat.

1 c.—Company will remove all loose rust and paint from exterior of tank, apply one (1) spot coat to all bare metal, and apply one (1) complete coat of paint to the exterior of tank, tower, riserpipe, all from the foundation up. All exterior paint is to be furnished by the Company. For the above the Total sum of \$1850.00 (One thousand eight hundred fifty dollars).

2. After tank has been inspected, Company will submit a flat sum bid for all such repairs as may be necessary. This bid will be submitted to First Party and a written repair contract embodying the specific work to be done, and the entire price to be paid,



shall be entered into by the Company and First Party before any repair work is done.

3 a.—Company will notify First Party as soon as the Company can conveniently do so of the date work under the contract will commence. However, such notice may be given by Company crew when it arrives to perform the work, and this, it is specifically agreed, shall be sufficient notice.

3 b.—First Party agrees to drain tank within twenty-four (24) hours after being notified that crew has arrived.

4. If all repairs, replacements, etc. as recommended by Company's inspectors are made and payment for the work performed is received by the Company then the Company warrants or guarantees all repair work in the performance of this contract under the provisions of the Company's Standard Form of Warranty or Guarantee. This warranty or guarantee shall extend for a period of twelve (12) years from the date the repairs under this contract are completed, provided the outside and inside of said tank is painted by the Company at the expiration of three (3) years from the date of such repairs with Dixie Asphalt Tankreliner, or paint of equal quality approved by the Company, and the outside painted with first-grade paint of any reliable paint manufacturer. The Company warrants the painting (both inside and outside) for a period of three (3) years from the date the painting is completed if the repairs as authorized by the Company are made or in the

event Company's inspection reveals that no repairs are necessary.

As a part of this warranty or guarantee and of this contract, the Company agrees to make necessary adjustments thereto, without cost or obligation to the First Party, from the date of completion of the work under this contract, and such warranty or guarantee will continue for another three (3) years in the event the Company shall re-paint said tank at the expiration of three (3) years from the completion of the work done under this contract at the Company's prevalent prices at that time; otherwise the guarantee on the painting and repairs will become null and void.

5 a.—If the repairs are not done as agreed upon in this contract or in the proposal of the Company to the First Party, then the provision with reference to the warranty or guarantee shall be inoperative and the Company shall not be responsible for any leaks in the tank, or for the structural soundness of the tank, and the First Party agrees to sign the Company's Standard Form of Release of Liability and warranty or guarantee. It is agreed that if company decides not to do the painting first party shall pay the company one-third of the contract price as set out in paragraph 1c.

5 b.—Company agrees that First Party shall have a period of three (3) days after being notified crew has arrived in which to make arrangements for First Party's inspector and to decide upon repair contract or other matters that may arise.

6. First Party has a right to have an inspector in the tank at all times, or whenever it is convenient for them to do so. It is agreed that the Company will correct any defects that shall arise while work is in progress. As pointed out by first party inspector as outlined in this contract. These defects and adjustments shall be made without any further cost to first party.

7. The Company agrees to furnish all necessary tools and equipment, and agrees to carry full coverage of Workmen's Compensation and Contractor's Public Liability Insurance, and agrees to furnish verification to the First Party that such insurance policies are in force and effect if the First Party shall request it. First Party agrees to make all arrangements for the Company to have entrance, parking and ground space for equipment and men to do the above described work at the tank.

8. The First Party shall pay to the Company, upon completion of the work agreed to be performed, the total of the sums set out in paragraph 1c of this contract, which shall be in full for all work performed and agreed to be performed by the Company under this contract.

9. The Company and all workmen employed by the Company shall conduct all operations in a clean and sanitary manner. No nuisance shall be committed in a tank; the workmen shall either use proper waste receptacles or leave the tank whenever necessity arises. First Party shall report any disorderly

conduct of the foreman and men by collect telegram to the Memphis Office and the Company shall remove them immediately upon such notification.

No one shall work in a tank if he has been under a physician's care, or has needed a physician's care, within a seven-day period prior to entering or working in the tank. No personnel shall be permitted to work in a tank who has an abnormal temperature or gives evidence of illness. The First Party, physician employed by him, shall be the judge of the physical fitness or unfitness of any person to enter or work in a tank. No deviation from this stipulation may be permitted.

The First Party, after work of any nature is done in a tank, is charged with satisfying himself that the tank interior is clean and sanitary before the tank is returned to service. Although the Company may be required by its contract to clean tank thoroughly before a tank is restored to service, it is the ultimate responsibility of the First Party either to give the tank a final field inspection or to require such laboratory tests of the quality of water held (for test purposes) in the tank as will demonstrate the good sanitary condition of the tank interior. If work is done to the entire satisfaction of the First Party, First Party shall give the Company a letter or recommendation to that effect. If not First Party is to notify the Company by collect telegram at their Memphis, Tennessee, Office and Company will see that all work is done to First Party's entire satisfaction as per contract.

The Company shall keep the premises clean and shall remove all trash and used materials placed there by the Company during the performance of this contract.

10. Parties signing this contract in behalf of First Party covenant and agree that they are fully authorized and empowered to sign, seal, deliver and execute the same and that all legal requirements have been fully complied with.

11. No verbal agreements or representations not incorporated in this contract shall be binding on either party as this contract contains the entire agreement.

DIXIE TANK & BRIDGE CO.,  
By OFFICE.

This contract must be countersigned by W. A. Riley or E. H. Riley before it is binding on the Company.

/s/ W. A. RILEY,  
President.

Dated this 21st day of September, A. D., 1956.

COUNTY OF ORANGE  
HOSPITAL,

By /s/ WILLIS H. WARNER,  
Chairman, Orange County  
Board of Supervisors.

Dated this 2nd day of October, A. D. 1956. [10]



EXHIBIT B

County of Orange  
Purchase Order

Order No. 62659

To: Dixie Tank & Bridge Company,  
P. O. Box 1,  
Memphis 1, Tennessee.

Santa Ana, Calif., Oct. 5, 1956

Please Furnish the Following to County of Orange

Ship To:

County of Orange Hospital,  
Maintenance Department,  
12071 Santa Ana Blvd.,  
Orange, California.

Fund: Hospital.

Via Rasmussen

If unable to fill Order exactly in accordance with description,  
unit and price hereon, ask Purchasing Agent for instructions.

Labor and material necessary to repair 100,000 gallon high tank,  
as per agreement on file in County Clerk's office, as follows:

Rig, scale and clean inside of tank with scaling machines to clean metal.....	Unit Price	Extension
		\$550.00
Weld all rusted out rivets. (Unit: ea.).....	\$ .60	
Weld all deteriorated seams. (Unit: per lin. ft.) .....	3.50	
Weld all pits in tank plates that are over halfway through tank plates. (Unit: ea.)..	.60	
Tighten and adjust all loose sway rods.....		150.00
Prime and reline interior of tank. ....		650.00
Remove loose rust and paint from exterior of tank and tower, and spot prime and repaint exterior of tower and tank. ....		650.00
Replace catwalk plates where necessary. ....		850.00

Your state contractor's license No. 110607.

This order is not valid until Labor and Materials Bond covering one-half of the total cost of completed job is filed with the County Purchasing Agent (Government Code Section #4200 of the State of California).

Contractor is to supply all insurance, licenses, permits and fees necessary to complete job.

Bid No. : 6933

-----  
Purchasing Agent.

/s/ ERMA GRAHAM,  
Acting P. A.

## EXHIBIT C

Form 5-C

Dixie Tank & Bridge Company  
Memphis, Tennessee

Standard Form of Contract For Emergency Repairs  
(For use in all States)

This Contract entered into for emergency repairs to water tanks, by and between Authorized Agent County of Orange Hospital Purchasing Dept, hereinafter known as First Party, and the Dixie Tank & Bridge Company, Memphis, Tennessee, hereinafter known as the Company,

Witnesseth:

It is agreed that any and all contracts between the First Party and the Company prior to the date of

this contract are merged into this contract, and this contract supersedes all previous agreements between the parties and is the sole contract between the First Party and the Company.

### Inspection

It is understood and agreed between the parties that a thorough inspection has been made of the tank belonging to the First Party and located at Orange Calif. (excluding the footings or foundation of the tank) and that the repairs outlined in the following paragraphs have been agreed upon by the parties as being necessary and essential.

1-(a)—It is understood and agreed between the parties that the Company shall do the following repair work and painting upon said tank for the price hereinafter stated:

Total amount of lineal feet of flat welding: .....	26
--	----

Total amount of lineal feet of vertical welding: .....	152
--	-----

Total amount of lineal feet of fingers to be welded in bottom .....	180
---	-----

Total amount of lineal feet of horizontal welding: .....	354
--	-----

Total amount of rivets to be welded:....	3616
--	------

Total amount of pits to be welded:.....	none
---	------

## Repairs

Tightening of rods, new steel, etc., or any miscellaneous list below:

Scale clean and paint interior and exterior of tank adjust all sway rods, Repair catwalk floor.

## Painting

1-(b)—The Company shall paint the interior of said tank with one (1) coat of Dixie Asphalt Tank Reliner, and also insulate seams and rivet heads on inside of tank. This paint will pass Federal Government Board of Health tests as being tasteless and non-poisonous; will expand and contract with heat or cold; will not chip, crack or peel, and will resist electrolysis, alkaline, iron and other minerals that are in the water. Water can be put in tank 24 hours after painting. The inside or under side of roof and spider rods are to be painted with exterior paints, one primer coat and one finish coat.

1-(c)—The Company shall paint the exterior of the tank, tower, riserpipe, all from the foundation up, with one (1) spot coat and one (1) finish coat of paint. (All exterior paint is to be furnished by the Company. First Party agrees to block off streets, alleys or other areas to prevent automobiles from parking where they might become damaged from falling paint.)

## Materials

1-(d)—The Company agrees to furnish all labor, welding rods, and interior paint, necessary under

this contract. The First Party agrees to furnish all electric current necessary to perform this contract, and also to furnish replacement steel, exterior paint, and all other materials necessary to perform this contract; but all of such materials which are to be furnished by the First Party shall be subject to approval as to quality by the Company.

### Payment

2—The First Party shall pay to the company, upon completion of the work agreed to be performed, the sum of \$7,511.60, which shall be in full for all work performed and agreed to be performed by the Company under this contract.

### Inspection

3—The Company specifically requests the First Party to have its inspector in the tank at all times while work is in progress, and First Party agrees to notify the Company of any defects in workmanship and if any such defects shall arise while the work is in progress, or during the period of the guarantee hereinafter mentioned; and the Company agrees to make all proper adjustments within a reasonable length of time after such notice, all such proper adjustments to be without cost from the Company.

### Outlets

4—It is agreed that the Company shall have the right to install outlets in the tank for ventilation or cleaning purposes. [12]



### Cathodic Device

5—In the event a cathodic or electrolytic device is installed in the tank after the repairs are made and while the warranty and provisions of the contract shall be in force, then the installation of such device shall terminate the guarantee, and shall operate to release the Company from any further liability by reason of this contract.

### Insurance

6—The Company agrees to furnish all necessary tools and equipment, and agrees to carry full coverage of Workmen's Compensation and Contractor's Public Liability Insurance, and agrees to furnish verification to the First Party that such insurance policies are in force and effect if the First Party shall request it.

### Premises

7—The First Party agrees to make all arrangements for the Company to have entrance to the premises and ample ground space for its equipment and men to do the above described work, at the location of the tank.

The Company and all workmen employed by the Company shall conduct all operations in a clean and sanitary manner. No nuisance shall be committed in a tank; the workmen shall either use proper waste receptacles or leave the tank whenever necessity arises. First Party shall report any disorderly

conduct of the foreman and men by collect telegram to the Memphis Office and the Company shall remove them immediately upon such notification.

No one shall work in a tank if he has been under a physician's care, or has needed a physician's care, within a seven-day period prior to entering or working in the tank. No personnel shall be permitted to work in a tank, who has an abnormal temperature or gives evidence of illness. The First Party, physician employed by him, shall be the judge of the physical fitness or unfitness of any person to enter or work in a tank. No deviation from this stipulation may be permitted.

The First Party, after work of any nature is done in a tank, is charged with satisfying himself that the tank interior is clean and sanitary before the tank is returned to service. Although the Company may be required by its contract to clean tank thoroughly before a tank is restored to service, it is the ultimate responsibility of the First Party either to give the tank a final field inspection or to require such laboratory tests of the quality of water held (for test purposes) in the tank as will demonstrate the good sanitary condition of the tank interior. If work is done to the entire satisfaction of First Party, First Party shall give the Company a letter of recommendation to that effect. If not First Party is to notify the Company by collect telegram at their Memphis, Tennessee Office and Company will see that all work is done to First Party's entire satisfaction as per contract.

The Company shall keep the premises clean and shall remove all trash and used materials placed there by the Company during the performance of this contract.

### Guarantee or Warranty

8—The Company upon payment for the work performed under this contract being received at Company's Memphis, Tennessee Office will issue its Standard Form of Warranty warranting all repair work and painting in the performance of this contract under the provisions of the Company's Standard Form of Warranty. No warranty will be issued and no warranty or guarantee shall be binding upon Company until full payment under this contract is received by Company at its Memphis, Tennessee Office. The guarantee on the painting of the inside and outside shall be for a period of three (3) years and the guarantee on the repair work shall be for twelve (12) years from the date the repairs under this contract are completed, provided First Party pays the Company the prevalent prices of the Company at that time for labor and material for painting of said tank, inside and outside, at the expiration of the guarantee on the painting. If Company does not re-paint tank as outlined above, the guarantee on the repairs and painting will become null and void.

As a part of this warranty or guarantee and of this contract, the Company agrees to make necessary adjustments thereto, without cost from the

Company to the First Party, and such warranty will continue for another three (3) years in the event the Company shall re-paint said tank at the expiration of three (3) years from the completion of the work done under this contract as outlined above.

### Release of Warranty

9—If the repairs and painting are not done as agreed upon in this contract or in the proposal of the Company to the First Party, then the provision with reference to the warranty or guarantee shall be inoperative and the Company shall not be responsible for any leaks in the tank, or for the structural soundness of the tank, and the First Party agrees to sign the Company's Standard Form of Release of Liability and warranty or guarantee.

First Party further agrees to drain tank and make the same available for work of adjustment crew, within 24 hours after notification by Company adjustment crew has arrived to make adjustments as reported by First Party, and failure to do so shall forthwith effect a cancellation of this guarantee of this contract and of the warranty.

### Waiting Time Penalty

10—It is agreed that the First Party shall pay the Company at the rate of thirty (\$30.00) dollars per crew hour for any delays or waiting time including waiting for payment after work is completed or other delays which may be caused by the First Party, which shall be in addition to the sum

set forth in paragraph (2). Waiting time is to be computed at the rate of eight (8) hours per day out of every twenty-four (24) hours as defined by a calendar day. Such waiting time is not to be effective for eight (8) hours after the Company has notified the First Party that the crew is ready to start work or has completed work. However, this waiting time clause shall become effective within eight (8) hours after the First Party has been notified the crew is ready to work or has completed work if any delay is then caused by the First Party.

### Tank Foundation

11—It is understood and agreed by the parties that no inspection has been made by the Company of the concrete footings foundation or building that tank may rest on, and no work whatever has been done thereon by the Company, and any defects therein—either latent or patent—are expressly excluded from the provisions of this contract and warranty and are the sole responsibility of the First Party. Company does not guarantee the riser pipe or frost jacket or tank, or any of its work done to riser pipe or frost jacket, including the expansion joint, even though Company makes repairs to or installs new riser pipe or frost jacket; as Company is not protected against possibility of First Party failing to take necessary precautions in freezing weather and other factors over which Company has no control.

12—The party or parties signing this contract on behalf of the First Party covenant and agree that



they are fully authorized and empowered to sign, execute and deliver the same, and that all legal requirements have been fully complied with.

13—No verbal agreements or representations, not incorporated in this contract, shall be binding on either party, as this contract contains the entire agreement. It is agreed that any construction of this contract shall be governed by the laws of Tennessee.

By /s/ WILLIS H. WARNER,  
Chairman, Orange County  
Board of Supervisors.

Dated this 7th day of Nov., A.D., 1956.

Attest:

L. B. WALLACE,  
County Clerk and Ex-Officio Clerk of the Board of  
Supervisors.

By /s/ MABEL L. CASTEIX,  
Deputy Clerk.

DIXIE TANK & BRIDGE CO.

By /s/ C. A. LINDSEY,  
Authorized Agent.

This contract must be countersigned by W. A. Riley or E. H. Riley before it is binding on the Company.

.....

Dated this..... day of..... A.D., 19....

## EXHIBIT D

County of Orange  
Change or Cancellation of Purchase Order

Date: November 13, 1956.

To: Dixie Tank & Bridge Company,  
P. O. Box 1,  
Memphis 1, Tennessee.

Order No.: 62659—10/5/56  
Department: Hospital.  
Dept. Req. No.: M2046A.

Note the Following Changes:

Please add the following to the above listed order:

Additional labor and material necessary to repair 100,000 gallon high tank .....	1,011.60
--	----------

[Longhand in margin]: Signed agreement following.

[Stamped]: Confirming. [13]

COURTNEY R. CHANDLER,  
Purchasing Agent;

By /s/ ERMA GRAHAM.

EXHIBIT E

A regular meeting of the Board of Supervisors of Orange County, California, was held August 28, 1956, at 9:30 a.m. The following named members being present: Willis H. Warner, Chairman, C. M. Featherly, Ralph J. McFadden, Wm. H. Hirstein, Heinz Kaiser and the Clerk.

In Re: Repair High Tank—Orange County Hospital

On motion of Supervisor Kaiser, duly seconded and unanimously carried, the Purchasing Agent was authorized to arrange for the repair of the high tank at the Orange County Hospital as requested by R. D. Powell, Orange County Hospital Director. Estimated cost per Requisition No. M2946A is \$6,500.00.

A regular meeting of the Board of Supervisors of Orange County, California, was held October 2, 1956, at 9:30 a.m. The following named members being present: Willis H. Warner, Chairman, C. M. Featherly, Wm. H. Hirstein, Heinz Kaiser and the Clerk. Absent: Ralph J. McFadden.

In Re: Contract—Cleaning, Scaling, Repairing, etc., Water Tank—Orange County Hospital

On motion of Supervisor Kaiser, duly seconded and unanimously carried by Board members present, the contract dated October 2, 1956, with the

Dixie Tank & Bridge Co., for the cleaning, scaling, repairing, etc., the 100,000 gallon water tank at the Orange County Hospital was approved and the Chairman was authorized to sign such contract.

A regular meeting of the Board of Supervisors of Orange County, California, was held November 7, 1956, at 9:30 a.m. The following named members being present: Willis H. Warner, Chairman, C. M. Featherly, Ralph J. McFadden, Wm. H. Hirstein, Heinz Kaiser and the Clerk.

In Re: Contract for Emergency Repairs—Repair  
High Water Tank Orange County Hospital  
—Dixie Tank and Bridge Company

On motion of Supervisor Kaiser, duly seconded and unanimously carried, the Chairman was authorized to sign the contract with Dixie Tank and Bridge Company for the repair of the High Water Tank at the Orange County Hospital, in the amount of \$7511.60.

A regular meeting of the Board of Supervisors of Orange County, California, was held November 7, 1956, at 9:30 a.m. The following named members being present: Willis H. Warner, Chairman, C. M. Featherly, Ralph J. McFadden, Wm. H. Hirstein, Heinz Kaiser and the Clerk.

In Re: Additional Amount—Labor and Material—  
High Water Tank—County Hospital

On motion of Supervisor Hirstein, duly seconded and unanimously carried, the Purchasing Agent

was authorized an additional amount of \$1,011.60, covering labor and material necessary to repair high water tank, 100,000-gallons, at the County Hospital.

Original minute order dated October 2, 1956. [14]

## EXHIBIT F

17066

### Mechanic's Lien

Notice Is Hereby Given: That Dixie Tank & Bridge Co., a corporation under Chapter II of Title IV of Part III of the California Code of Civil Procedure, claims a lien upon the parcel of land situate in the County of Orange, State of California, and upon the buildings situate thereon, which land is described as follows, to wit: the Orange County General Hospital tract, formerly known as 12071 Santa Ana Boulevard (or street), near the City of Orange, California, and which premises, claimant is informed and believes, is described as the tract of about 10 acres more or less occupied by the Orange County General Hospital at southwest corner of Placentia and West Chapman Streets, including elevated water tank thereon, as per map recorded in Book .... at Page .... of Records of ..... County, California.



Said Lien is claimed for labor and material for cleaning, painting and repairing the elevated water tank aforesaid, done and furnished at the request of Orange County Board of Supervisors, Orange County Purchasing Agent, and Board of Hospital Commissioners, for and used in the work of improvement of said tank between the second day of October, 1956, and the 21st day of November, 1956.

That the amount due claimant and unpaid on account of said contract, after deducting all just credits and offsets, is the sum of \$7,511.60, with interest from November 24, 1956.

That the County of Orange, a subdivision of the State of California, is the reputed owner of said buildings, premises and tank.

Dated this 1st day of February, 1957.

DIXIE TANK & BRIDGE CO.,

By /s/ W. A. RILEY,  
President.

(Verification for other than Individual Claim)

State of Tennessee,  
County of Shelby—ss.

W. A. Riley being first duly sworn, deposes and says:

That Dixie Tank & Bridge Co. the Claimant herein, is a corporation organized in State of Tennessee, that affiant is the president of said corpora-

tion and for that reason he makes his affidavit on behalf of said corporation that he has read the same and knows the contents thereof, and that the statements therein contained are true; and that it contains, among other things, a correct statement of the demand of Claimant, after deducting all just credits and offsets.

/s/ W. A. RILEY,  
President.

Subscribed and sworn to before me February 4, 1957, Shelby County, State of Tennessee.

[SEAL] By /s/ ETHEL H. RILEY,  
Notary Public in and for said  
County and State.

My Commission expires June 22, 1960.

Recorded at request of James C. R. McCall, Book 3796 Page 334, February 7, 1957. Official Records of Orange County, California.

/s/ RUBY McFARLAND,  
County Recorder.

Complaint amended:

7-22-57

10-18-57

[Endorsed]: Filed May 7, 1957. [15]

[Title of District Court and Cause.]

Civil Action No. 597-57Y

AMENDED AND SUPPLEMENTAL  
COMPLAINT

(For Money, to Enforce Mechanic's Lien and  
Declaratory Relief)

First Cause of Action

Comes plaintiff above named and, by leave of Court heretofore granted, amends and supplements its Complaint filed herein on May 7, 1957, by filing this Amended and Supplemental Complaint, and for cause of action against the defendants alleges:

I.

That jurisdiction of this action rests on Title 28 U.S. Code Sec. 1332, Subsection (a) (1).

II.

That at all times mentioned herein, plaintiff Dixie Tank & Bridge Co. was, and now is, a corporation duly organized and existing under and by virtue of the laws of the State of Tennessee, with its office and principal place of business at Memphis, Tennessee; and is a citizen of Tennessee. That at all times mentioned herein, [16] plaintiff was, and now is, a duly licensed contractor under the laws of the State of California.

III.

That at all times mentioned herein, the defendant County of Orange was, and now is, duly established

and organized as a County, under the laws of, and within, the State of California. That defendant Willis H. Warner, at all such times, was and is the Chairman of the Board of Supervisors of said County. That both of said defendants are citizens of the State of California.

#### IV.

That in the year 1956, plaintiff and the defendant County entered into three separate agreements in writing, wherein the plaintiff agreed to furnish the material and labor necessary therefor, and to clean, paint and repair the 100,000 gallon elevated water tank of the defendant County located at the Orange County General Hospital operated by the defendant County, and situated at or near the Town of Orange, within said County, upon the lands hereinafter described, and wherein the defendant County agreed to pay plaintiff therefor separately, sums totaling \$7,511.60, upon completion of said work. That said work was reasonably and necessarily divided into three or more contracts, work projects, or orders, because the necessary repairs to said tank, especially the amount of welding necessary to make the same water tight could not be determined until after the cleaning and scaling thereof. That the separate work projects or orders respectively involved therein, and the agreed price for each, were contracted for as follows:

(1). On August 28, 1956, the Board of Supervisors of said County in a regular meeting assembled, voted unanimously to authorize the Purchasing

Agent of said County to arrange for the repair of said tank at an estimated cost of \$6,500.00 as provided in Requisition No. M2946A. The Purchasing Agent duly solicited bids [17] from qualified contractors, including plaintiff, and duly reported plaintiff's bid as the lowest received in response to such invitation to bid.

(2). On October 2, 1956, the Board of Supervisors duly met and unanimously voted to authorize its Chairman aforesaid to sign for said County a contract with plaintiff obligating plaintiff to clean and paint said tank for a price of \$1,850.00, a copy of which contract is hereto attached, marked Exhibit A and incorporated herein in full by this reference; and pursuant thereto, said contract was duly signed by plaintiff and the defendant County, acting through its Chairman.

(3). On October 5, 1956, Erma Graham, Acting Purchasing Agent of said County, by authority of the Board of Supervisors, granted on August 28, 1956 as aforesaid, and pursuant to the invitation for bids aforesaid, issued to plaintiff the County's Order No. 62659, whereby the County further employed plaintiff to tighten and adjust all loose sway rods and to replace catwalk plates of said tank where necessary, for a price of \$1,000.00. That a copy of said Order No. 62659 is hereto attached, marked Exhibit B and incorporated herein in full by this reference. (The issuance of said work order was ratified by the Board of Supervisors on November 7, 1956, as next shown).



(4). Plaintiff duly cleaned the tank, which revealed that to render it water tight would require the welding of 3616 rusted out rivets and 712 lineal feet of seams, the price of which work, as set forth in plaintiff's bid aforesaid was 60c each for welding rivets and \$3.50 per lineal foot for welding the seams, making a total price for welding of both rivets and seams \$4,661.60. On November 7, 1956, with knowledge of all the foregoing, the Board of Supervisors again met and unanimously voted to authorize the Purchasing Agent to spend \$1,011.60 additional to the \$6,500.00 authorized on August 28, 1956, to complete said work and also to [18] authorize its Chairman to enter into a contract with plaintiff for said welding, a copy of which is hereto attached, marked Exhibit C and incorporated herein in full by this reference, and pursuant thereto plaintiff and the defendant County, acting through said Chairman, on November 7, 1956 signed said contract for said work. This Contract (Exhibit C), together with the contracts set forth in Exhibits A and B hereto, total \$7,511.60.

(5). On November 13, 1956, Courtney R. Chandler, Purchasing Agent of said County, issued to plaintiff a change order for \$1011.60 additional to the \$6500.00 originally authorized as aforesaid; and a copy of said change order is hereto attached marked Exhibit D and incorporated herein in full by this reference. That copies of the minutes of the Board of Supervisors relating to the letting of said contracts are consolidated into the paper which is

attached hereto marked Exhibit E and incorporated herein in full by this reference.

#### V.

That plaintiff began the work called for by the first of said contracts on or about October 5, 1956, and completed the work required by each of them on November 21, 1956, on which date the work was accepted and approved by the said County's agent and representative in charge thereof. That the plaintiff fully kept and performed all the terms and conditions of said contracts on its part to be performed, and has offered, and now offers, to issue its standard form of warranty and guarantee (provided for in clause 4 of the contract dated October 2, 1956) covering the maintenance of said tank for a period of twelve years from date, upon condition that defendant County pay its just claim for said work in the sum of \$7,511.60. [19]

#### VI.

That plaintiff made written demand on said County for payment of the \$7,511.60 aforesaid on November 24, 1956, and thereafter, for nearly six months, unsuccessfully negotiated with said Board of Supervisors and its representatives for payment of all, or any part, of the respective sums justly due to plaintiff under the contracts, Exhibits A, B, C, and D. That on or about May 18, 1957, plaintiff duly filed with and presented to the Board of Supervisors of said County four verified claims for its work under said contracts, setting forth as to each such contract true facts hereinabove alleged for sums due plaintiff thereon as follows:

	Amount Claimed
Under the Contract	
Claim No. 1—Ex. A. Dated: October 2, 1956.....	\$1,850.00
Claim No. 2—Ex. B. Dated: October 5, 1956.....	1,000.00
Claim No. 3—C & D. Dated: November 7 & 13, 1956.	4,661.60
	<hr/>
	\$7,511.60
Claim No. 4—Ex. A-C, incl. Dated: October 2-Novem- ber 7, 1956, and quantum meruit. ....	\$7,511.60

That the Board of Supervisors in a regular meeting assembled on May 28, 1957, voted unanimously to deny and reject each of said four claims. That a copy of the minutes of the action of said Board thereon is hereto attached marked Exhibit E-1 and incorporated herein in full by this reference.

## VII.

That the land upon which said tank was so cleaned, repaired and painted under said agreements is described as follows, to wit:

A parcel of land situated in the County of Orange, State of California, known as the Orange County General Hospital Tract, formerly known as 12071 Santa Ana Boulevard, near the City of Orange, California, consisting of [20] about 10 acres, more or less, and occupied by the Orange County General Hospital, at the southwest corner of Placentia and West Chapman Streets.

That the whole thereof is required for the convenient use and occupation of said premises.

## VIII.

That at all times mentioned herein the defendant County was the owner and reputed owner of said

land and of the buildings and water tank erected thereon.

### IX.

That on February 7, 1957, plaintiff filed for record in the office of the County Recorder of said County of Orange, its claim and notice of lien in writing, duly verified, a copy of which is attached hereto marked Exhibit F and made a part hereof; and which said claim and notice was thereafter on the same day duly recorded in said office in Book 3796, Page 334 of Official Records of Orange County, California, therein. That plaintiff paid \$2.50 for verifying and recording said lien.

### Second Cause of Action

For a second, separate and distinct cause of action against the defendants, plaintiff incorporates herein, by this reference, all of the allegations contained in all paragraphs of the First Cause of Action, *supra*, except paragraphs IV and V thereof, and in place and stead of said two paragraphs, alleges:

### I.

That on and between October 2, 1956, and November 21, 1956, at the special instance and request of defendant County of Orange, and upon its promise to pay the reasonable value thereof, made through its duly authorized representatives, to wit, the Board of Supervisors, the Chairman of said Board, and the Purchasing Agent of said County, plaintiff furnished and performed work and labor

and materials necessary for the cleaning, painting and repair of [21] the 100,000 gallon elevated water tank of the defendant County, situated on the premises known as the Orange County General Hospital Tract, which labor and material were furnished and consumed in said work; and that said labor and materials were of the reasonable worth and value of \$7,511.60, no part of which has been paid. That plaintiff completed said work, and the same was duly accepted by the County on November 21, 1956; and that on or about May 18, 1957, plaintiff duly filed with and presented to the Board of Supervisors of said County a verified claim for its work and materials so furnished in said sum of \$7,511.60; and that the said Board in a regular meeting assembled on May 28, 1957, unanimously voted to deny and reject said claim.

### Third Cause of Action

For a third, separate and distinct cause of action against the defendants plaintiff incorporates herein by this reference all of the allegations contained in all of the paragraphs of the First Cause of Action, *supra*, and in addition alleges the following facts:

#### I.

That in, and as a part of, the aforesaid written contracts between plaintiff and the defendant County dated October 2, 1956, and November 7, 1956 (Exhibits A and C hereto), the defendant Willis H. Warner covenanted with plaintiff that he, the said Willis H. Warner, was fully authorized and empowered to sign, execute and deliver such



contracts on behalf of said County, and that all legal requirements therefor had been fully complied with. That plaintiff confided in and relied upon said personal covenant of said Chairman of the Board of Supervisors in entering into and performing the work and furnishing the materials aforesaid, and that plaintiff was induced and led to perform said work and furnish said materials by means thereof. [22]

## II.

That plaintiff is informed and believes, and on such belief alleges that notwithstanding the due execution and performance of the said contracts on the part of plaintiff, the defendant County refuses to pay anything whatever for plaintiff's work and materials furnished in good faith thereunder on the alleged ground that each and all of said contracts are void and unenforceable because, as defendants contend, although there was actual competitive bidding on invitations for bids for said work, the Chairman of the Board allegedly did not advertise for bids in a local newspaper as allegedly required by Sections 25450 and 25452 of the Government Code of California. That plaintiff is informed and believes, and on the basis thereof alleges that the various work projects involved in said contracts were not required to be so advertised, and that the contracts were each validly entered into and are each enforceable against the County; but that if, and to the extent that any of them may be void and unenforceable against the County because of such alleged defect in failing to advertise for

bids, the defendant Willis H. Warner is personally liable to plaintiff on his covenants aforesaid for the oversight and for plaintiff's resulting loss in performing the said contracts.

Wherefore, plaintiff demands judgment as follows:

1. Against the defendant County of Orange and the defendant Willis H. Warner, in the sum of \$7,511.60, together with interest thereon at the rate of seven per cent per annum from November 24, 1956, and for plaintiff's costs, and the sum of \$2.50 for filing and recording the lien notice aforesaid; and that the premises hereinabove described be sold and the proceeds thereof applied to the payment of said judgment, interest and costs.

2. That the Court decree and declare whether, and to what extent, if any, the contracts for the work aforesaid are [23] invalid under Sections 25450 and 25452 of the Government Code of the State of California; and

3. For all such other, further and different relief as the Court deems just in the premises.

/s/ JAMES C. R. McCALL,  
Attorney for Plaintiff.

[Exhibits A-F attached to the foregoing are identical to Exhibits A-F attached to the Original Complaint.] [24]

## EXHIBIT E-1

Minutes of the Board of Supervisors  
of Orange County, California

May 28, 1957.

A regular meeting of the Board of Supervisors of Orange County, California, was held May 28, 1957, at 9:30 a.m. The following named members being present: Willis H. Warner, Chairman; C. M. Featherly, William J. Phillips, Wm. H. Hirstein, Heinz Kaiser and the Clerk.

In Re: Claims — Dixie Tank and Bridge Company — High Water Tank at Orange County Hospital — Denied.

On motion of Supervisor Kaiser, duly seconded and unanimously carried, the four claims designated as Claim No. 1 in the sum of \$1850.00, Claim No. 2 in the sum of \$1000.00, Claim No. 3 in the sum of \$4661.60 and Claim No. 4 in the sum of \$7511.60 of the Dixie Tank and Bridge Company, dated May 14, 1957, pertaining to rigging, cleaning, descaling, painting, repairing, etc., the 100,000 gallon elevated water tank located at the Orange County General Hospital at Orange, California, received by the County Clerk on May 20, 1957, were denied and ordered referred to the County Counsel for study and recommendation.

State of California,  
County of Orange—ss.

[Title of District Court and Cause.]

I, L. B. Wallace, County Clerk and ex-officio Clerk of the Board of Supervisors of Orange County, California, hereby certify the foregoing to be a full, true and correct copy of the minute entry on record in this office.

In Witness Whereof, I have hereunto set my hand and seal this 28th day of May, 1957.

/s/ L. B. WALLACE,

County Clerk and ex-officio Clerk of the Board of Supervisors of Orange County, California.

[Endorsed]: Filed July 22, 1957.

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ANSWER TO AMENDED AND SUPPLEMENTAL COMPLAINT AND DEFENSES

Defendants admit, deny, and allege as follows:

First Defense

1. Admit Paragraphs I, II, and III.
2. Admit the allegations of Paragraph IV in so far as said Paragraph alleges Plaintiff and Defendant County, and Defendant Warner, acting as agent for Defendant County, entered into two written agreements, one dated September 21, 1956, and one dated November 7, 1956, for the purpose de-

scribed in the first sentence of Paragraph IV, lines 11 through 20, Page 2, of the Amended Complaint; deny that said work was reasonably and necessarily divided into three or more contracts, work projects or orders; deny that separate contracts, work projects, or orders were involved; admit that on August 28, 1956, the Board of Supervisors of Defendant County authorized the Purchasing Agent of Defendant [32] County to arrange for the repair of the tank referred to in the Amended Complaint at an estimated cost of \$6,500.00 as provided in Requisition No. M2946A; deny that the Purchasing Agent duly solicited bids from qualified contractors; allege Purchasing Agent wrote letters to some contractors and received two answers, one from the Plaintiff; deny any of the provisions of Article 5, Chapter 5, Part 2, Division 2 of Title 3, Government Code of the State of California (Sections 25450 and following) were complied with; specifically deny any advertisement for bids took place regarding any work or material regarding the tank; admit Paragraph IV (2), (3), (4) and (5), line 4 on Page 3 through line 16 on Page 4 of the Amended Complaint.

3. Admit the allegations of Paragraph V, except the claim referred to in line 28 of Page 4 of the Complaint is not a "just claim," but is "a claim."

4. Admit the allegations of Paragraph VI, except the facts referred to in line 10, Page 5, are not "true facts," but are "alleged facts."



5. Admit the allegations of Paragraph VII, VIII and IX.

Answering the Purported "Second Cause of Action":

1. Defendants incorporate hereby the admissions, denials, and allegations set forth in response to the purported "First Cause of Action."

2. Admit the allegations of Paragraph I of the purported "Second Cause of Action."

Answering the Purported "Third Cause of Action":

1. Defendants incorporate hereby the admissions, denials, and allegations set forth in response to the purported "First Cause of Action."

2. Admit the allegations of Paragraph I of the purported "Third Cause of Action," except that Plaintiff relied upon or confided in any [33] particular representation of Defendant Warner; deny that Plaintiff relied upon or confided in any particular representation of Defendant Warner; deny that said covenant was a personal covenant; deny there was any induction or leading of the Plaintiff by anyone; allege that one C. A. Lindsey, purporting to act as an authorized agent for the Plaintiff, also signed the contract referred to as Exhibit "C", and thereby also represented that all legal requirements have been fully complied with.

3. Admit the allegations of the first sentence of Paragraph II of the purported "Third Cause of

Action," lines 2 through 12, Page 8 of the Amended Complaint, except the recitation, which the Defendants deny, that "there was actual competitive bidding on invitation for bids for said work," lines 8 and 9 on said page; deny the second sentence of said paragraph, lines 12 through 20 on said page.

### Second Defense

The Complaint fails to state a claim against Defendants, or either of them, upon which relief can be granted.

Wherefore, Defendants pray for:

1. Dismissal of this action with costs assessed against Plaintiff in favor of Defendants;
2. Such other relief as the Court may deem just.

Dated: July 29, 1957.

JOEL E. OGLE,  
County Counsel;

STEPHEN K. TAMURA,  
Assistant;

ADRIAN KUYPER,  
Deputy.

By /s/ ADRIAN KUYPER,  
Deputy, Attorneys for  
Defendants.

Certificate of service by mail attached.

[Endorsed]: Filed July 30, 1957. [34]

[Title of District Court and Cause.]

MOTION AND NOTICE OF MOTION FOR  
JUDGMENT ON THE PLEADINGS AND  
FOR DISMISSAL TOGETHER WITH  
STATEMENT OF THE CASE AND  
POINTS AND AUTHORITIES

Defendants County of Orange and Willis H. Warner move the Court to enter Judgment on the Pleadings in favor of said Defendants and to dismiss this cause at the Plaintiff's costs for the reason that the Plaintiff in his Complaint, as amended, has failed to state a claim against the Defendants, or either of them, upon which relief can be granted.

Notice Is Hereby Given to Dixie Tank & Bridge Co. and to James C. R. McCall, its attorney,

That Defendants County of Orange and Willis H. Warner will, on September 9, 1957, in the above-entitled Court, at 10:00 o'clock a.m. make this motion.

Dated: July 29, 1957.

JOEL E. OGLE,  
County Counsel;

STEPHEN K. TAMURA,  
Assistant;

ADRIAN KUYPER,  
Deputy.

By /s/ ADRIAN KUYPER,  
Deputy, Attorneys for  
Defendants. [36]

Statement of the Case and  
Points and Authorities

The events upon which the Complaint is attempted to be founded arose out of work done by the Plaintiff on a high-water tank located on the grounds of the Orange County General Hospital in the fall of 1956. As shown by the copy of the Minute Order of the Board of Supervisors of the County of Orange, dated August 28, 1956 (part of Exhibit "E" to the Complaint), the original estimate of the job was \$6,500.00. There is no indication that this estimate was ever less than this amount. The estimated cost was increased on or about November 7, 1956, by the amount of \$1,011.60 making a total bill of \$7,511.60, which is the amount finally billed and the amount prayed for in the Complaint.

The Government Code of the State of California by its Section 25450 provides, "whenever the estimated cost of any construction of any \* \* \* public building or the cost of any repairs thereto exceeds the sum of \$4,000.00 \* \* \* the work shall be done by contract. Any such contract not let pursuant to this article is void." (Emphasis added.)

The article referred to requires advertising for bids and adoption of plans and specifications (Sections 25452 and 25451); neither advertising for bids nor adoption of plans or specifications occurred in connection with this job; none is alleged in the Complaint; such action is specifically denied by the Answer.

The California cases construing this act are quite clear that not only is the contract void, but no recovery in quantum meruit is allowed.

Miller vs. McKinnon, 20 Cal. 2d 83, 124 P. 2d 34, was a taxpayer's action to recover over \$42,000.00 expended by Santa Clara County on repairing a rock quarry. The trial court dismissed the action after sustaining a demurrer to the complaint on the ground that no action was stated. The Supreme Court reversed with directions to overrule the demurrer. The Court stated such contracts as are let without [37] competitive bidding cannot be ratified, that no estoppel to deny their validity can be invoked against the County for entering into contracts without such bidding, that no recovery in quasi contract can be had pursuant to such contracts. The Court also pointed out that persons dealing with any public agency are presumed to know the law with respect to the requirement of competitive bidding and act at their peril. Extensive citations of authority to support these general propositions are found on page 88 of 20 Cal. 2d and page 37 of 124 P. 2d. The Court, in addition, stated that the job cannot be split into separate parts as a device for thwarting the public policy declared in the Government Code.

County of San Diego v. California Water and Telephone Company, 30 Cal. 2d 817, 186 P. 2d 124, was an action by a County against a utility company to enjoin the completion of a dam on which the company had already spent \$800,000.00, because



the work was causing a flooding of a county highway. The utility company alleged the county had abandoned the highway in question and had accepted an easement from the company for another location. The easement contained an agreement that the company would not be liable for flooding damage to the highway. The Court held the agreement was *ultra vires* and void. There was no estoppel. The Court stated that neither the doctrine of estoppel nor any other equitable principle may be invoked against a governmental body where it would operate to defeat the effective operation to protect the public.

Nor can Mr. Warner, the Chairman of the Board of Supervisors acting as agent for the County, in signing the various contracts alleged in the Complaint, be held liable:

“When an officer or public agent contracts in good faith with parties having knowledge of the extent of his authority or who have equal means of knowledge, especially where the authority of the officer is [38] prescribed by law, he will not become individually responsible unless the intent to incur liability is clearly expressed, although it should be found that, through ignorance of the law, he may have exceeded his authority.” (McQuillin 4 Municipal Corporations 163, Section 12.214.) (Emphasis added.) [39]

Certificate of service by mail attached.

[Endorsed]: Filed July 30, 1957.

[Title of District Court and Cause.]

AFFIDAVIT IN SUPPORT OF MOTION FOR  
JUDGMENT ON THE PLEADINGS AND  
FOR DISMISSAL

State of California,  
County of Orange—ss.

Affiant deposes and says:

That Affiant's name is Erma Graham and that Affiant is Assistant Purchasing Agent for the County of Orange and held such position at all times mentioned herein; that Affiant received a copy of a Minute Order of the Board of Supervisors of the County of Orange dated August 28, 1956, which authorized the Purchasing Agent to "arrange for the repair of the high tank at the Orange County Hospital"; that Affiant caused to be made forms for the receipt of bids from contractors for this repair and sent the same to four or five contractors including the Dixie Tank & Bridge Company; that Affiant received two replies on these forms, one of which was withdrawn prior to the date set for final acceptance of the bids; that the one remaining bid was that submitted [41] by the Dixie Tank & Bridge Company; that there was no advertising for bids for the performance of the work, as required by Section 25452 of the Government Code; that there were no plans, specifications, strain sheets, and working details for the work adopted by the Board of Supervisors, as required by Section 25451 of the Government Code.

Dated: June 14th, 1957.

/s/ ERMA GRAHAM.

Subscribed and Sworn to Before Me this 14th day of June, 1957.

[Seal] /s/ ELIZABETH M. HEEMSTRA,  
Notary Public in and for Said  
County and State.

My Commission Expires Dec. 30, 1958.

Certificate of service by mail attached.

[Endorsed]: Filed July 30, 1957. [42]

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[Title of District Court and Cause.]

## MINUTES OF THE COURT

September 18, 1957

Present: Hon. Leon R. Yankwich, District Judge;

Deputy Clerk: L. Cunliffe; Reporter  
Marie Zellner.

Counsel for Plaintiff: James C. R. Mc-  
Call, Esq.

Counsel for Defendant: Adrian Kuyper  
and Stephen Tamura.

### Proceedings:

Re-hearing on motion of defendants County of  
Orange and Willis H. Warner for judgment on the  
pleadings and for dismissal:

Court makes statement.

Attorney McCall makes statement and moves that order of submission made September 16, 1957, be set aside and that plaintiff be allowed to present further memorandum of points and authorities in support of plaintiff's opposition to the motion for judgment, etc.

Attorney Kuyper, for defendants—offers no opposition to plaintiff attorney's motion to offer further brief but does oppose plaintiff's motion to set aside order of submission.

Court orders plaintiff's motion to set aside order of submission denied.

Attorney McCall makes further statement, and

It Is Ordered that defendants' motion for judgment on the pleadings and for dismissal be granted with leave to plaintiff to file amended complaint within 30 days, or up to and including October 19, 1957, and that such amended complaint set forth all the facts that occurred and shall include in addition to the exhibits already submitted any other resolutions of the Board of Supervisors of Orange County indicating their intentions in the matter and further that such amended complaint is to set forth separately cause of action against individual defendant, Willis H. Warner, in the allegations.

JOHN A. CHILDRESS,

Clerk;

By /s/ L. CUNLIFFE,

Deputy Clerk. [44]

[Title of District Court and Cause.]

SECOND AMENDED AND SUPPLEMENTAL  
COMPLAINT

(For Money)

First Cause of Action

Comes plaintiff, Dixie Tank & Bridge Co., and by leave of Court heretofore granted, files this Second Amended and Supplemental Complaint in lieu of the complaint filed herein on May 7, 1957, and the Amended and Supplemental Complaint filed herein on July 22, 1957, and for cause of action against the defendant, County of Orange, alleges:

I.

Jurisdiction of this action rests on Title 28 U. S. Code Sec. 1332, Subsection (a) (1).

II.

At all times mentioned herein, plaintiff Dixie Tank & Bridge Co. was, and now is, a corporation duly organized and [45] existing under and by virtue of the laws of the State of Tennessee, with its office and principal place of business at Memphis, Tennessee; and is a citizen of Tennessee. At all times mentioned herein, plaintiff was, and now is, a duly licensed contractor under the laws of the State of California.

III.

At all times mentioned herein, the defendant County of Orange was, and now is, a duly estab-



lished and organized county within, and under the laws of, the State of California. Defendant, Willis H. Warner, at all such times, was and is a resident of such county and the chairman of the Board of Supervisors thereof. Both of said defendants are citizens of the State of California.

#### IV.

At all times mentioned herein, the defendant County owned and operated the Orange County General Hospital located near Orange, California, and owned and used in connection therewith a 100,000 gallon elevated steel water tank standing on the hospital property; and at all such times R. D. Powell was the director of said hospital and the County's employee in charge of its operation; and W. E. H. Rasmussen was the superintendent of buildings and grounds at said hospital, and the County's representative in charge of the plaintiff's work hereinbelow mentioned. Between October 2, 1956, and November 7, 1956, through and pursuant to actual and bona fide competitive bidding therefore, the Board of Supervisors of Orange County awarded and let to plaintiff, in a series of written contracts, for separate prices, the performance of eight certain and separate work orders or projects, all relating to the cleaning, repair and painting of said tank. The combined total contract price of said eight separate work projects was \$7,511.60. Between October 2, 1956, and November 21, 1956, plaintiff duly performed [46] said eight work

projects and everything required of plaintiff under said written contracts, to the satisfaction of the defendant County, which, on the latter date, accepted plaintiff's performance thereof as satisfactory by and through W. E. H. Rasmussen, it's representative in charge of said work. No part of the agreed contract price for any of said work has been paid; and though justly indebted to plaintiff therefor ever since November 21, 1956, the defendant County has continuously to date failed and refused to pay plaintiff therefor, despite its due demands therefor.

## V.

The eight work orders or projects so performed by plaintiff and the agreed contract price for each are shown in the following table which contains also a separate project number by which said respective work orders or projects are hereinafter sometimes referred to in this complaint:

Project No.	Description of Project	Contract Price
1	Rig, scale and clean inside of tank with scaling machine to clean metal. ....	\$ 550.00
2	Weld all rusted out rivets (3,616 at 60 cents each)	2,169.60
3	Weld all deteriorated seams (712 feet at \$3.50 per foot). ....	2,492.00
4	Weld all pits in tank plates that are over halfway through tank plates (none at 60 cents each).....	
5	Tighten and adjust all loose sway rods. ....	150.00
6	Prime and reline interior of tank. ....	650.00
7	Remove loose rust and paint from exterior of tank and tower, and spot prime and repaint exterior of tower and tank. ....	650.00
8	Replace catwalk plates where necessary. ....	850.00

The total tank work was divided or separated into the above [47] eight projects by the County, acting through the above-named hospital officials and the Board of Supervisors, before bids were requested of contractors for the performance thereof, and plaintiff and other bidders were instructed to and did bid a price for each project, the amounts of plaintiff's bids therefor being the contract prices shown above.

## VI.

After completion and acceptance of said eight work projects on November 21, 1956, plaintiff on November 24, 1956, made written demand on defendant County for payment of the agreed prices therefor totaling \$7,511.60, and thereafter, for nearly six months, unsuccessfully negotiated with the Board of Supervisors of said County and its representatives for payment of all or any part, of the respective sums shown in the above table. That on or about May 18, 1957, plaintiff filed with and presented to the Board of Supervisors four verified claims for its work on said eight projects under said contracts, setting forth as to each contract the particular work order or project, above listed, and each project covered thereby. The Board of Supervisors in a regular meeting thereof on May 28, 1957, voted unanimously to deny and reject each and all of plaintiff's said four claims, in full. The four claims were:

	Amount Claimed
For Work Under Contract	
Claim No. 1—Dated: Oct. 2, 1956.	
Project No.: 1, 6 & 7.....	\$1,850.00
Claim No. 2—Dated: Oct. 5, 1956.	
Project No.: 5 & 8. ....	1,000.00
Claim No. 3—Dated: Nov. 7, 1956.	
Project No.: 2 & 3. ....	4,661.60
Claim No. 4—All contracts and quantum meruit—all but 4. ....	\$7,511.60
Total. ....	<hr/> \$7,511.60

## VII.

Plaintiff is informed and believes, and on such information [48] and belief alleges, that the Board of Supervisors rejected, and now refuses to pay plaintiff's claims for the above work upon the alleged grounds that said Board of Supervisors neglected, in letting said contracts to plaintiff, to perform its alleged statutory duty under government code Sections 25452 and 25451 by failing to advertise for bids for such work in a daily newspaper published in Orange County and by failing to "adopt plans, specifications, strain sheets, and working details for the work," before contracting with plaintiff for said work; and plaintiff is informed, believes and states that inasmuch as the control of the defense of this action is vested in said Board of Supervisors under the provisions of government code Section 25203, the defendant County will inject said claims of malfeasance by said Board of Supervisors in defense of this action upon the theory that the Board's alleged shortcomings in those respects rendered the contracts

with plaintiff void and unenforceable against the County under the provisions of Government Code Section 25450.

### VIII.

Plaintiff is informed, believes and represents that said proposed defenses are legally insufficient to constitute a defense on the facts of this case, even if true, and further that the defendant County is, and ought to be held, estopped to plead or prove such facts, by the following facts, to wit:

1. The total tank repair work was naturally and necessarily divided or separated by the County and the Board of Supervisors into the eight work orders or projects aforesaid, and competitive bids therefor were solicited, for the purpose of enabling the County to perform by day's work and more economically such parts of the eight projects for which the bids received were too high in the opinion of the proper county officials, and for the purpose of securing fair and [49] economical unit bids for the welding work involved in projects Nos. 2, 3 and 4 above, the needed extent of which could not be ascertained or determined before the tank had been rigged, cleaned and descaled. The tank work was not split into such smaller work orders or projects for the purpose of evading the statute requiring public work to be done by contract after competitive bidding, within the prohibition of Government Code Section 25450.5, but was split by the County and Board of Supervisors in good faith and for the bona fide purposes hereinabove stated, and Govern-



ment Code Section 25450 was and is inapplicable to the letting of said work projects to plaintiff.

2. On October 2, 1956 and November 7, 1956, in regular meeting assembled, the Board of Supervisors had before it for consideration the written contracts proposed to be entered into with plaintiff for the performance of the work, and unanimously voted to authorize and direct the chairman of said Board to execute said specific contracts with plaintiff. Each of said contracts at that time contained, and after execution, now contains, a covenant that the person signing the contract on behalf of the County "was fully authorized and empowered to sign, execute and deliver the same and that all legal requirements have been fully complied with." By authorizing and directing the chairman to sign said contracts containing such covenant, the Board of Supervisors and the County estopped themselves from now contending and offering to prove that the alleged legal requirements for advertising in a newspaper for bids and adoption of working details, had not been complied with.

3. Plaintiff, at the time of the execution of said contracts and its performance of the work called for thereby, reasonably believe that the Board of Supervisors had performed and complied with all legal requirements in letting said contracts [50] to plaintiff, and in good faith relied upon said representation by the Board of Supervisors in accepting and performing said contracts and; will be inequitably, certainly and irritrievably damaged if

the Board of Supervisors and the County are permitted to rely upon and prove such alleged breaches by the Board of its legal duties.

## IX.

The labor and materials furnished by plaintiff and consumed in the performance of said work were of the reasonable worth and value of \$7,511.60, and the reasonable worth and value of the labor and material furnished and consumed in the performance of each of said eight work orders or projects by plaintiff is equal to the above-stated contract price therefor; and the defendant County has accepted and is using and intends to keep the product of plaintiff's said work and material without paying plaintiff anything therefor.

## X.

Attached hereto and incorporated herein in full by this reference are copies of the documents reflecting the letting and performance of the contracts between the plaintiff and defendant County, said copies being marked Exhibits hereto as follows:

## Table of Exhibits

Ex. No. & Document	Date
A: Requisition No. M2946A. ....	8-23-56
B: Request for Bid and Plaintiff's Bid.....	9- 4-56
C: Request for Bid and E. R. Waites' Bid.....	9-18-56
D: Contract for Projects Nos. 1, 6 & 7 (\$1,850.).	10- 2-56
E: Purchase Order No. 62659. ....	10- 5-56
F: Contract (Final). ....	11- 7-56
G: Change Order. ....	11-13-56
	[51]
H: Acceptance of work by County. ....	11-21-56
I: Plaintiff's Bill for work. ....	11-24-56

## XI.

The work was let and performed as follows:

1. On August 23, 1956, the director of the Orange County General Hospital filed with the purchasing agent of said County requisition No. M2946A (Exhibit "A") for repair of the tank divided into the eight work orders or projects aforesaid. This requisition was transmitted by the hospital committee of the Board of Supervisors to said Board with the recommendation that the purchasing agent of the County be authorized to arrange for making these repairs as so divided. On August 28, 1956, the Board of Supervisors at a regular meeting unanimously adopted and passed a motion recited in its minutes as follows:

"In Re: Repair High Tank—Orange County Hospital:

"On motion of Supervisor Kaiser, duly seconded and unanimously carried, the Purchasing Agent was authorized to arrange for the repair of the high tank at the Orange County Hospital as requested by R. D. Powell, Orange County Hospital Director. Estimated cost per Requisition No. M2946A is \$6,500.00."

2. Pursuant to this authority the purchasing agent on August 31, 1956, under the Docket "Bid No. 6933" mailed a Request for Bid to five contractors, in the form shown by Exhibits "B" and "C" hereto. The request listed the eight work projects above mentioned and requested unit prices, ex-

tension and the total as to each, with the right reserved to the County to reject any and all bids; and required all bids to be returned by September 18, 1956. The request was sent by the purchasing agent to the following prospective bidders:

Pacific Brick & Tank Coating Co., 1051 E. Wardlow Road, [52] Long Beach, California;

Pittsburgh-Des Moines Steel Co., P.O. Box 2012, El Monte, California;

Dixie Tank & Bridge Co., P.O. Box 1, Memphis 1, Tennessee;

Pittsburg Tank & Tower Co., c/o M. C. Mattis, 861 So. Palm, Anaheim, California;

West Coat Corrosion Engineering Corp., c/o D. N. Sullivan, P.O. Box 1164, Santa Ana, California.

3. In response to this solicitation by the purchasing agent, two bids were submitted, each listing prices for each of the eight work projects. A copy of the bid submitted by Dixie Tank & Bridge Co., plaintiff, is Exhibit "B" hereto. The bid submitted by E. R. Waites resulting from solicitation of Pittsburgh Tank & Tower Co., is Exhibit "C" hereto. The Waites' bid was withdrawn on September 18, 1956.

4. On September 19, 1956, the purchasing agent by letter inquired of plaintiff concerning its inspection service and guarantee of its work for a period of years after performing tank repair work.

Plaintiff signed and forwarded its standard form of contract for cleaning, scaling and painting, a copy of which is Exhibit "D" hereto, on September 21, 1956. On October 2, 1956, this standard form contract was considered by the Board of Supervisors of Orange County at a regular meeting and by unanimous vote the Board took action with respect thereto, as shown by its minutes, as follows:

"In Re: Contract—Cleaning, Scaling, Repairing, Etc., Water Tank—Orange County Hospital:

"On motion of Supervisor Kaiser, duly seconded and unanimously carried by Board members present, the contract dated October 2, 1956, with the Dixie Tank & Bridge Co., for the cleaning, scaling, repairing, etc., the 100,000 gallon water tank at the Orange County Hospital was approved and the Chairman was authorized to sign such contract."

On the same day the chairman of the Board, pursuant to this authority, signed said contract, a copy of which is Exhibit "D" hereto. This contract provided that for \$1,850.00 plaintiff [53] would rig, clean and scale the inside of the tank for inspection by the County and that after the tank had been so inspected plaintiff would submit a flat sum bid for repairs to the tank and that a written repair contract for specific repair work to be done and the entire price to be paid would thereafter be entered into by plaintiff and the County before any repair work would be done. It also contained, in Paragraph 10 thereof as follows:



“Parties signing this contract in behalf of first party (the County) covenant and agree that they are fully authorized and empowered to sign, seal, deliver and execute the same and that all legal requirements have been fully complied with.” (Parenthetic insertion ours.)

5. On October 5, 1956, the County purchasing agent notified plaintiff of the execution of the above contract and sent plaintiff the County's purchase order No. 62659, a copy of which is Exhibit “E” hereto. This purchase order included the items covered by the above contract (Projects Nos. 1, 6 and 7) and in addition Projects Nos. 5 and 8 at an additional \$1,000.00, making the total price agreed upon at a flat sum of \$2,850.00, and leaving the amount of welding covered by Projects Nos. 2, 3 and 4 to be determined and ascertained in a later contract as provided in the contract Exhibit “D” hereto.

6. Plaintiff rigged, cleaned and descaled the tank and the County's inspection then revealed that there were 3,616 rusted out rivets and 712 lineal feet of seams which needed welding. On November 7, 1956, at a regular meeting of the Board of Supervisors the matter of such welding was brought before the Board and a final contract covering the additional work was submitted. At said meeting the Board, by vote, unanimously authorized and directed its chairman to sign said contract, and in addition authorized the purchasing agent to expend an [54] additional \$1,011.60 on the tank work. The action

taken by the Board at that time, as reflected by its Minutes was as follows:

“In Re: Additional Amount—Labor and Material,  
High Water Tank—County Hospital:

“On motion of Supervisor Hirstein, duly seconded and unanimously carried, the Purchasing Agent was authorized an additional amount of \$1,011.60, covering labor and material necessary to repair high water tank, 100,000 gallons, at the County Hospital.

“Original minute order dated October 2, 1956.”

“In Re: Contract for Emergency Repairs—Repair  
High Water Tank, Orange County Hospital,  
Dixie Tank and Bridge Company:

“On motion of Supervisor Kaiser, duly seconded and unanimously carried, the Chairman was authorized to sign the contract with Dixie Tank and Bridge Company for the repair of the High Water Tank at the Orange County Hospital, in the amount of \$7,511.60.”

Pursuant to this authority the Chairman on November 7, 1956, signed with Dixie Tank and Bridge Company the contract covering the items of welding (Projects Nos. 2 and 3), along with the work already contracted for and substantially completed, a copy of which final contract is Exhibit “F” hereto. This contract fixed the price for all the work done or to be done by plaintiff at \$7,511.60 and in Paragraph 12 thereof provided:

“The party or parties signing this contract on behalf of the first party (the County) covenant and agree that they are fully authorized to sign, execute and deliver the same and that all legal requirements have been fully complied with.”

7. On November 13, 1956, plaintiff was informed of the Board's execution of the contract of November 7, 1956, and the purchasing agent issued to plaintiff a change order for additional labor and material in the sum of \$1,011.60, a copy of which is attached as Exhibit “G” hereto. Plaintiff [55] thereupon completed the work on November 21, 1956, and on that date the same was inspected and accepted by the County as reflected by the letter of W. E. H. Rasmussen, Superintendent of Buildings and Grounds, a copy of which is Exhibit “H” hereto. On November 24, 1956, plaintiff billed the County for the eight projects in the total sum of \$7,511.60, a copy of which bill is hereto attached marked Exhibit “I.”

## XII.

By reason of the foregoing, the defendant County is justly indebted to plaintiff in the sum of \$7,511.60, together with interest thereon at the rate of seven per cent per annum from November 24, 1956, to date of judgment.

## Second Cause of Action

For a second, separate and distinct cause of action against the defendant, Willis H. Warner, plaintiff Dixie Tank and Bridge Co. incorporates by

this reference all of the allegations contained in all of the paragraphs of the first cause of action, *supra*, and in addition alleges:

### I.

On October 2, 1956, in executing that certain contract for cleaning, scaling, inspecting and painting the elevated water tank hereinabove mentioned, between plaintiff and defendant Orange County, a copy of which is hereto attached and marked Exhibit "D" and incorporated herein by this reference, the defendant, Willis H. Warner, in Paragraph 10 thereof, contracted and covenanted with plaintiff as follows:

"Parties signing this contract on behalf of first party covenant and agree that they are fully authorized and empowered to sign, seal, deliver and execute the same and that all legal requirements have been fully complied with." [56]

### II.

On November 7, 1956, in signing the final contract between said County and plaintiff, a copy of which is hereto attached marked Exhibit "F" and incorporated herein by this reference, the defendant Willis H. Warner covenanted with plaintiff in Paragraph 12 thereof as follows:

"The party or parties signing this contract on behalf of first party covenant and agree that they are fully authorized and empowered to sign, execute and deliver the same, and that all legal requirements have been fully complied with."

III.

In said quoted clauses the words "the party or parties signing this contract" refer and mean the defendant Willis M. Warner; and the words "the first party" refer to and mean the County of Orange; and the words "that all legal requirements have been fully complied with" refer to and mean that all legal requirement for making the contract by the County had been fully complied with.

IV.

Plaintiff is informed, believes and states that the County of Orange contends and will defend this action upon the alleged grounds that legal requirements for the making of said contracts had not been complied with in that there had been no newspaper advertising for bids as allegedly required by Government Code, Section 25452, and that the Board of Supervisors had not adopted plans, specifications, strain sheets and working details for the work as allegedly required by Government Code, Section 25451; and hence, the two contracts were void and unenforceable under the provision of Government Code, Section 25450. [57]

V.

If the defendant County is permitted to contest this action on said grounds and plaintiff, on said grounds, shall be denied recovery against the County under the first cause of action, then and in that event plaintiff will have been subjected to damages in the sum of \$7,511.60 by reason of and as



the proximate result of the breach of said covenants that all legal requirements had been fully complied with.

## VI.

That plaintiff relied upon said covenants of the defendant Willis H. Warner in entering into and performing said contracts.

Wherefore, plaintiff demands judgment as follows:

1. Against the defendant County of Orange in the sum of \$7,511.60, together with interest thereon at the rate of seven per cent per annum from November 24, 1956; and

2. In the alternative, for judgment against the defendant Willis H. Warner in the sum of \$7,511.60 as damages for breach of covenant under the Second Cause of Action.

3. For all such further, other and different relief as the Court deems just in the premises.

/s/ JAMES C. R. McCALL,  
Attorney for Plaintiff. [58]

*Wm G. Brown*

COUNTY OF ORANGE  
**REQUISITION**

No. **100000**

Date **8-28-24**

TO THE PURCHASING AGENT:

The following materials or supplies are required by

**HOSPITAL**

(Full Name and Department)

Please arrange for their purchase and delivery

Deliveries to be made to (address)

**MAINTENANCE**

on or before

Quantity	DESCRIPTION	AMOUNT		PURCHASING AGENT'S DATA	
		Dollars	Cents	FROM WHOM ORDERED	ORDER NO.
	Repair of 100,000 Gal. High tank at Orange County General Hospital.			<i>Rein. Tank &amp; Bridge</i>	<i>67459</i>
	Sub-Total	505	00		
	Rig, scale and clean inside of tank with scaling machine to clean metal.				
	Weld all rusted out rivets. Weld all deteriorated seams. Weld all pits in tank plates that are over halfway thru tank plates.				
	Tighten and adjust all loose army rods.			<i>Repair &amp; Replacement</i>	
	Prime and relime interior of tank.			<i>Operation &amp; Maintenance</i>	
	Remove loose rust and paint from exterior of tank and tower and spot prime and re-paint exterior of tower and tank.			<i>See 2 - Budget to item 10</i>	
	Replace catwalk plates where necessary.				
	Sub-total	5,915	00		
	(Budget Item 48)				
	Grand Total	64,500	00		
	<i>Bond &amp; Co. Inc. etc.</i>				
	<i>Wm G. Brown</i>				

Materials or supplies to be used or required for

*Wm G. Brown*

Requisition issued by

(Head of Department or Chief Deputy)

MA-20-240

1007 1:10

EXHIBIT "A"



## EXHIBIT B

Request for Bid  
(Not an Order)

Bid No. 6933

Santa Ana, Calif., August 31, 1956

Please quote your lowest prices On This Sheet for the following material, f.o.b. County of Orange Hospital, 12071 Santa Ana Blvd., Orange, California.

No charge will be allowed for package or drayage unless so specified on this bid.

Unit prices, extension and total must be made by bidder.

The right is reserved to reject any or all bids. This sheet must be signed below by bidder.

When bidding on goods other than specified, bidder must state brand quoted on and give catalogue reference.

Bid number must show on outside of bid envelope.

Samples submitted must be tagged with dealer's name.

Bids must be signed by bidder or his agent.

Quotations will be received until September 18, 1956, 10:00 a.m.

Bids will not be accepted unless this sheet is returned with prices thereon.

Labor and material necessary to repair 100,00-gallon high tank as follows:

## Articles Required

	Unit Price	Total
Rig, scale and clean inside of tank with scaling machines to clean metal. ....		\$550.00
Weld all rusted out rivets. (Unit: each.).....	\$0.60	Amount unknown
Weld all deteriorated seams. (Unit: per lineal foot.) .....	3.50	Amount unknown
Weld all pits in tank plates that are over halfway through tank plates. (Unit: each.) .....	.60	Amount unknown
Tighten and adjust all loose sway rods.....		150.00
Prime and reline interior of tank. ....		650.00

Remove loose rust and paint from exterior of tank and tower and spot prime and re-paint exterior of tower and tank. ....	650.00
Replace catwalk plates where necessary. ....	850.00

Please Give Us Your State Contractor's License Number:  
No. 110607.

In the event total cost exceeds \$500.00, it will be necessary for successful bidder to furnish a Labor and Materials bond covering one half of the total cost of completed job. Bond to be filed with County Purchasing Agent (Government Code Section #4200 of the State of California).

Contractor is to supply all insurance, licenses, permits and fees necessary to complete job.

Please return your bid on this form.

Please type bid number on outside of envelope.

All materials must be American made.

September 4, 1956

We have stated hereon the prices at which we will furnish the articles or services as specified above.

We will make delivery within.....days from receipt of order. Discount will be allowed as follows:.....

DIXIE TANK AND BRIDGE COMPANY,

By /s/ W. A. RILEY,  
President.

Important—Bid should be sealed with Bid Number as shown above, on outside of envelope, and mailed to Glad Bower, County Purchasing Agent, Santa Ana, Calif.

## EXHIBIT C

Request for Bid  
(Not an Order)

Bid No. 6933

Santa Ana, Calif., August 31, 1956

Please quote your lowest prices On This Sheet for the following material, f.o.b. County of Orange Hospital, 12071 Santa Ana Blvd., Orange, California.



No charge will be allowed for package or drayage unless so specified on this bid.

Unit prices, extension and total must be made by bidder.

The right is reserved to reject any or all bids. This sheet must be signed below by bidder.

When bidding on goods other than specified, bidder must state brand quoted on and give catalogue reference.

Bid number must show on outside of bid envelope.

Samples submitted must be tagged with dealer's name.

Bids must be signed by bidder or his agent.

Quotation will be received until September 18, 1956, 10:00 a.m.

Bids will not be accepted unless this sheet is returned with prices thereon.

Labor and material necessary to repair 100,00-gallon high tank as follows:

Articles Required

	Unit Price	Total
Rig, scale and clean inside of tank with scaling machines to clean metal. ....	\$200.00	\$ 200.00
Weld all rusted out rivets. (Each).....	.45	.45
Weld all deteriorated seams. (Per lin. ft.)	2.40	2.40
Weld all pits in tank plates that are over halfway through tank plates. (.45 each)	.45	.45
Tighten and adjust all loose sway rods. (24 @ 8.50) .....	204.00	204.00
Prime and reline interior of tank. ....	200.00	200.00
Remove loose rust and paint from exterior of tank and tower and spot prime and repaint exterior of tower and tank.	325.00	325.00
Replace catwalk plates where necessary...	75.00	75.00
		<hr/> \$1,007.30

Please Give Us Your State Contractor's License Number.

No. 96624C33.

In the event total cost exceeds \$500.00, it will be necessary for successful bidder to furnish a Labor and Materials bond covering one-half of the total cost of completed job. Bond to be filed

with County Purchasing Agent (Government Code Section #4200 of the State of California).

Contractor is to supply all insurance, licenses, permits and fees necessary to complete job.

Please return your bid on this form.

Please type bid number on outside of envelope.

All materials must be American made.

Sept. 18, 1956

We have stated hereon the prices at which we will furnish the articles or services as specified above.

We will make delivery within five days from receipt of order. Discount will be allowed as follows: None.

By /s/ C. R. WAITES,  
Bidder.

Important—Bid should be sealed with Bid Number as shown above, on outside of envelope, and mailed to Glad Bower, County Purchasing Agent, Santa Ana, Calif.

## EXHIBIT D

Form 4-C

Dixie Tank & Bridge Company  
Memphis, Tennessee  
Contract for Cleaning, Scaling,  
Inspecting and Painting

This contract entered into for emergency repairs by and between Authorized Agent, County of Orange Hospital, County Purchasing Department, hereinafter known as First Party and the Dixie Tank & Bridge Company, Memphis, Tennessee, hereinafter known as the Company.

Witnesseth:

1. The Company agrees to do the following described work for First Party on its 100,000 gallon elevated water tank located at Orange, California, to wit:

1. a—Company will rig, clean and scale the inside of the tank, so inspection can be made together with the inspectors of First Party to determine what, if any, repairs are necessary, First Party shall furnish electric current to perform work. Company shall have the right to install outlets in the tank for ventilation and cleaning purposes at our prevailing prices.

1. b—Company will furnish all labor and material to paint the interior of said tank with one (1) coat of Dixie Asphalt Tank Reliner. This paint will pass Federal Government Board of Health tests as being tasteless and non-poisonous, will expand and contract with heat or cold, will not chip, crack or peel, and will resist electrolysis, alkaline, iron or other minerals that are in the water. Water can be put in tank 24 hours after painting. The inside or under side of roof and spider rods are to be painted with exterior paint, one primer coat and one finish coat.

1. c—Company will remove all loose rust and paint from exterior of tank, apply one (1) spot coat to all bare metal, and apply one (1) complete coat of paint to the exterior of tank, tower, riserpipe, all from the foundation up. All exterior paint is to be

furnished by the Company. For the above the Total sum of \$1,850.00 (One thousand eight hundred fifty dollars).

2. After tank has been inspected, Company will submit a flat sum bid for all such repairs as may be necessary. This bid well be submitted to First Party and a written repair contract embodying the specific work to be done, and the entire price to be paid, shall be entered into by the Company and First Party before any repair work is done.

\* \* \*

10. Parties signing this contract in behalf of First Party covenant and agree that they are fully authorized and empowered to sign, seal, deliver and execute the same and that all legal requirements have been fully complied with.

11. No verbal agreements or representations not incorporated in this contract shall be binding on either party as this contract contains the entire agreement.

DIXIE TANK & BRIDGE CO.,

By OFFICE,

Authorized Agent.

This contract must be countersigned by W. A. Riley or E. H. Riley before it is binding on the Company.

/s/ W. A. RILEY,

Pres.

Dated this 21st day of September A. D., 1956.

COUNTY OF ORANGE  
HOSPITAL,

By /s/ WILLIS H. WARNER,  
Chairman Orange County  
Board of Supervisors.

Dated this 2nd day of October AD, 1956. [62]

EXHIBIT E

County of Orange  
Purchase Order

Order No. 62659

Santa Ana, Calif., Oct. 5, 1956.

To: Dixie Tank & Bridge Company,  
P. O. Box 1,  
Memphis 1, Tennessee.

Please Furnish the Following to County of Orange

Ship to:

County of Orange Hospital,  
Maintenance Department,  
12071 Santa Ana Blvd.,  
Orange, California.

Fund: Hospital.

Via Rasmussen

If unable to fill Order exactly in accordance with description,  
unit and price hereon, ask Purchasing Agent for instruc-  
tions.

Labor and material necessary to repair 100,000 gallon high  
tank, as per agreement on file in County Clerk's office, as  
follows:

	Unit Price	Extension
Rig, scale and clean inside of tank with scal- ing machines to clean metal. ....		\$550.00



Weld all rusted out rivets. (Unit: ea.).....	\$ .60
Weld all deteriorated seams. (Unit: per lin. ft.) .....	3.50
Weld all pits in tank plates that are over halfway through tank plates. (Unit: ea.)..	.60
Tighten and adjust all loose sway rods.....	150.00
Prime and reline interior of tank. ....	650.00
Remove loose rust and paint from exterior of tank and tower, and spot prime and repaint exterior of tower and tank. ....	650.00
Replace catwalk plates where necessary. ....	850.00
Your state contractor's license #110607.	

This order is not valid until Labor and Materials Bond covering one-half of the total cost of completed job is filed with the County Purchasing Agent (Government Code Section #4200 of the State of California).

Contractor is to supply all insurance, licenses, permits and fees necessary to complete job.

Bid No. 6933

-----  
Purchasing Agent.

/s/ ERMA GRAHAM,  
Acting P. A.

Purchase Order #62659  
October 5, 1956

## EXHIBIT F

Form 5-C

Dixie Tank & Bridge Company  
Memphis, Tennessee  
Standard Form of Contract for Emergency Repairs  
(For use in all States)

This Contract entered into for emergency repairs to water tanks, by and between Authorized

Agent, County of Orange, Hospital Purchasing Dept., hereinafter known as First Party, and the Dixie Tank & Bridge Company, Memphis, Tennessee, hereinafter known as the Company.

Witnesseth:

It is agreed that any and all contracts between the First Party and the Company prior to the date of this contract are merged into this contract, and this contract supersedes all previous agreements between the parties and is the sole contract between the First Party and the Company.

Inspection

It is understood and agreed between the parties that a thorough inspection has been made of the tank belonging to the First Party and located at Orange, Calif. (excluding the footings or foundation of the tank), and the repairs outlined in the following paragraphs have been agreed upon by the parties as being necessary and essential.

1-(a)—It is understood and agreed between the parties that the Company shall do the following repair work and painting upon said tank for the price hereinafter stated:

Total amount of lineal feet of flat welding, 26.

Total amount of lineal feet of vertical welding,  
152.

Total amount of lineal feet of fingers to be welded in bottom, 180.

Total amount of lineal feet of horizontal welding, 354.

Total amount of rivets to be welded, 3,616.

Total amount of pits to be welded, none.

### Repairs

Tightening of rods, new, steel, etc., or any miscellaneous list below:

Scale clean and paint interior and exterior of tank. Adjust all sway rods. Repair catwalk floor.

### Painting

1-(b)—The Company shall paint the interior of said tank with one (1) coat of Dixie Asphalt Tank Reliner, and also insulate seams and rivet heads on inside of tank. This paint will pass Federal Government Board of Health tests as being tasteless and non-poisonous; will expand and contract with heat or cold; will not chip, crack or peel, and will resist electrolysis, alkaline, iron or other minerals that are in the water. Water can be put in tank 24 hours after painting. The inside or under side of roof and spider rods are to be painted with exterior paints, one primer coat and one finish coat.

1-(c)—The Company shall paint the exterior of the tank, tower, riserpipe, all from the foundation up, with one (1) spot coat and one (1) finish coat of paint. All exterior paint is to be furnished by the

Company. First Party agrees to block off streets, alleys or other areas to prevent automobiles from parking where they might become damaged from falling paint.

### Materials

1-(d)—The Company agrees to furnish all labor, welding rods, and interior paint, necessary under this contract. The First Party agrees to furnish all electric current necessary to perform this contract, and also to furnish replacement steel, exterior paint, and all other materials necessary to perform this contract; but all of such materials which are to be furnished by the First Party shall be subject to approval as to quality by the Company.

### Payment

1—The First Party shall pay to the company, upon completion of the work agreed to be performed, the sum of \$7,511.60, which shall be in full for all work performed and agreed to be performed by the Company under this contract.

### Inspection

3—The Company specifically requests the First Party to have its inspector in the tank at all times while work is in progress, and First Party agrees to notify the Company of any defects in workmanship and if any such defects shall arise while the work is in progress, or during the period of the guarantee hereinafter mentioned; and the Com-

pany agrees to make all proper adjustments within a reasonable length of time after such notice, all such proper adjustments to be without cost from the Company. [64]

\* \* \*

12—The party or parties signing this contract on behalf of the First Party covenant and agree that they are fully authorized and empowered to sign, execute and deliver the same, and that all legal requirements have been fully complied with.

13—No verbal agreements or representations, not incorporated in this contract, shall be binding on either party, as this contract contains the entire agreement. It is agreed that any construction of this contract shall be governed by the laws of Tennessee.

DIXIE TANK & BRIDGE CO.,

By /s/ C. A. LINDSEY,  
Authorized Agent.

This contract must be countersigned by W. A. Riley or E. H. Riley before it is binding on the Company.

.....

Dated this .... day of ..... A.D., 19...

By /s/ WILLIS H. WARNER,  
Chairman, Orange County  
Board of Supervisors.



Dated this 7th day of Nov. A.D., 1956.

Attest:

L. B. WALLACE,

County Clerk and Ex-Officio Clerk of the Board of  
Supervisors.

By /s/ MABEL L. CASTEIX,  
Deputy Clerk. [64-A]

EXHIBIT G

County of Orange  
Change or Cancellation of Purchase Order

Date: November 13, 1956.

Order No.: 62659, 10/5/56.

Department: Hospital.

Dept. Req. No.: M2046A.

To: Dixie Tank & Bridge Company,  
P. O. Box 1,  
Memphis 1, Tennessee.

Note the Following Changes:

Please add the following to the above listed order:

Additional labor and material necessary to  
repair 100,000 gallon high tank.

\$1,011.60.

[Longhand in margin]: Signed agreement following.

[Stamped]: Confirming.

COURTNEY R. CHANDLER,  
Purchasing Agent.

By /s/ ERMA GRAHAM. [65]

## EXHIBIT H

11-21-56.

Mr. Tamura,  
County Counsel's Office,  
W. E. H. Rasmussen.

### Repairs to High Tank

I have inspected the job done by Dixie Tank & Bridge Co., and find they have completed the repairs to my satisfaction, both as to the interior and exterior. I therefore recommend they be paid according to contract.

/s/ W. E. H. RASMUSSEN,  
Sup't. Bldgs. & Grounds. [66]

EXHIBIT I

Dixie Tank & Bridge Company  
Lamar Avenue  
Memphis 1, Tennessee

November 24, 1956.

County of Orange,  
County Purchasing Department,  
P. O. Box 564,  
Santa Ana, California.

Attention: Mr. Clad Bower, Purchasing Agent:

Re: Your 100,000 gallon water tank at Orange  
County General Hospital, Orange, Cali-  
fornia.

Per Purchase Order No. 62659, Dated Octo-  
ber 5, 1956. Scaling, Cleaning and Paint-  
ing Interior and Exterior, Labor & Ma-  
terial .....\$1,850.00  
Welding of 712 feet seams @ 3.50 per lineal  
foot ..... 2,492.00  
Welding of 3616 Rivets @ .60 per rivet ... 2,169.60  
Tighten and adjust all loose Sway Rods .. 150.00  
Replace catwalk plates where necessary ... 850.00  
  
Total .....\$7,511.60

Affidavit of Service by Mail attached.

[Endorsed]: Filed October 18, 1957. [67]

[Title of District Court and Cause.]

ANSWER TO SECOND AMENDED AND  
SUPPLEMENTAL COMPLAINT

Defendants answer the Second Amended and Supplemental Complaint as follows:

First Defense

1. Admit paragraphs I, II and III.
2. Admit the first sentence of paragraph IV, lines 15 through 24 of page 2, of the Second Amended Complaint; in answer to the remainder of said paragraph, admit the allegations thereof insofar as said paragraph alleges Plaintiff and Defendant County entered into two (2) written agreements, one dated October 2, 1956, and one dated November 7, 1956, relating to the cleaning, repair and painting of the tank alleged; [69] deny that any competitive bidding took place; deny there was a series of written contracts for separate prices; deny that there were separate work projects; deny that the Defendant County is indebted to Plaintiff.
3. Deny the allegations of paragraph V.
4. In answer to paragraph VI, deny there were any separate projects.
5. In answer to paragraph VII, admit Defendants take the position that none of provisions of Article 5, Chapter 5, Part 2, Division 2 of Title 3, Government Code of the State of California (Sec-

tions 25450 and following) were complied with; specifically deny any advertising took place for bids regarding any work or material regarding the tank; specifically deny any adoptions of any plans or specifications took place; deny that such a position is a claim of "malfeasance by said Board" or "alleged shortcomings."

6. Deny the allegations of paragraph VIII.

7. In answer to paragraph IX, deny there were any separate work orders or projects.

8. In answer to paragraph XI, deny there were eight (8) work orders or projects, and deny the legal conclusions of such paragraph.

9. Deny the allegations of paragraph XII.

Answering the Purported "Second Cause of Action":

1. Defendants incorporate hereby the admissions, denials and allegations set forth in response to the purported "First Cause of Action." [70]

2. Deny the allegations in paragraphs I, III, V and VI of the purported "Second Cause of Action," except that Defendant Warner signed the alleged contracts.

### Second Defense

The Second Amended and Supplemental Complaint fails to state a claim against Defendants, or either of them, upon which relief can be granted.



Wherefore, Defendants pray for:

1. Dismissal of this action, with costs assessed against Plaintiff in favor of Defendants;
2. Such other relief as the Court may deem just.

Dated: November 4, 1957.

JOEL E. OGLE,  
County Counsel;

STEPHEN K. TAMURA,  
Assistant;

ADRIAN KUYPER,  
Deputy;

By /s/ ADRIAN KUYPER,  
Deputy, Attorneys for De-  
fendants.

Certificate of Service by Mail attached.

[Endorsed]: Filed November 6, 1957. [71]

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[Title of District Court and Cause.]

MOTION AND NOTICE OF MOTION FOR  
JUDGMENT ON THE PLEADINGS AND  
FOR DISMISSAL TOGETHER WITH  
STATEMENT OF THE CASE AND POINTS  
AND AUTHORITIES

Defendants County of Orange and Willis H.  
Warner, move the Court to enter Judgment on the

Pleadings in favor of said Defendants and to dismiss this cause at the Plaintiff's costs for the reason that the Plaintiff in his Complaint, as amended, has failed to state a claim against the Defendants, or either of them, upon which relief can be granted.

Notice Is Hereby Given to Dixie Tank & Bridge Co., and to James C. R. McCall, its attorney.

That Defendants County of Orange and Willis H. Warner will, on November 18, 1957, in the above-entitled Court, at 10:00 o'clock a.m., make this motion.

Dated: November 4, 1957.

JOEL E. OGLE,  
County Counsel;

STEPHEN K. TAMURA,  
Assistant;

ADRIAN KUYPER,  
Deputy;

By /s/ ADRIAN KUYPER,  
Deputy, Attorneys for De-  
fendants. [73]

Statement of the Case and  
Points and Authorities

The events upon which the Complaint is attempted to be founded arose out of work done by the Plaintiff on a high-water tank located on the grounds of the Orange County General Hospital

in the fall of 1956. As shown by the copy of the Minute Order of the Board of Supervisors of the County of Orange, dated August 28, 1956 (part of Exhibit "E" to the Complaint), the original estimate of the job was \$6,500.00. There is no indication that this estimate was ever less than this amount. The estimated cost was increased on or about November 7, 1956, by the amount of \$1,011.60 making a total bill of \$7,511.60, which is the amount finally billed and the amount prayed for in the Complaint.

The Government Code of the State of California by its Section 25450 provides, "whenever the estimated cost of any construction of any \* \* \* public building or the cost of any repairs thereto exceeds the sum of \$4,000.00 \* \* \* the work shall be done by contract. Any such contract not let pursuant to this article is void." (Emphasis added.)

The article referred to requires advertising for bids and adoption of plans and specifications (Sections 25452 and 25451); neither advertising for bids nor adoption of plans or specifications occurred in connection with this job; none is alleged in the Complaint; such action is specifically denied by the Answer.

The California cases construing this act are quite clear that not only is the contract void, but no recovery in quantum meruit is allowed.

Miller v. McKinnon, 20 Cal. 2d 83, 124 P.2d 34, was a taxpayer's action to recover over \$42,000.00

expended by Santa Clara County on repairing a rock quarry. The trial court dismissed the action after sustaining a demurrer to the complaint on the ground that no action was stated. The Supreme Court reversed with directions to overrule [74] the demurrer. The Court stated such contracts as are let without competitive bidding cannot be ratified, that no estoppel to deny their validity can be invoked against the County for entering into contracts without such bidding, that no recovery in quasi contract can be had pursuant to such contracts. The Court also pointed out that persons dealing with any public agency are presumed to know the law with respect to the requirement of competitive bidding and act at their peril. Extensive citations of authority to support these general propositions are found on page 88 of Cal. 2d and page 37 of 124 P.2d. The Court, in addition, stated that the job cannot be split into separate parts as a device for thwarting the public policy declared in the Government Code.

County of San Diego v. California Water and Telephone Company, 30 Cal. 2d 817, 186 P.2d 124, was an action by a County against a utility company to enjoin the completion of a dam on which the company had already spent \$800,000.00, because the work was causing a flooding of a county highway. The utility company alleged the county had abandoned the highway in question and had accepted an easement from the company for another location. The easement contained an agreement that the

company would not be liable for flooding damage to the highway. The Court held the agreement was ultra vires and void. There was no estoppel. The Court stated that neither the doctrine of estoppel nor any other equitable principle may be invoked against a governmental body where it would operate to defeat the effective operation to protect the public.

Nor can Mr. Warner, the Chairman of the Board of Supervisors acting as agent for the County, in signing the various contracts alleged in the Complaint, be held liable:

“When an officer or public agent contracts in good faith with parties having knowledge of the extent of his authority or who have equal means of knowledge, especially where [75] the authority of the officer is prescribed by law, he will not become individaually responsible unless the intent to incur liability is clearly expressed, although it should be found that, through ignorance of the law, he may have exceeded his authority.” (McQuillin 4 Municipal Corporations 163, Section 12.214.) (Emphasis added.)

Certificate of Service by Mail attached.

[Endorsed]: Filed November 6, 1957. [76]



[Title of District Court and Cause.]

PLAINTIFF'S MEMORANDUM ON  
MOTIONS FOR JUDGMENT

Preliminary Statement

For the Court's convenience in comparing the former and present county building or public works statutes of California (formerly Political Code Sec. 4041.18, now Government Code Sec. 25351, Sec. 25450, Sec. 25466) with each other, and with the various doctrines approved in *Miller v. McKinnon*, 20 Cal. 2d 83, 124 Pac. 2d 34, 140 A.L.R. 570 (1942), the pertinent parts of the statutes and opinion are copied at length into appendices attached to this Brief, together with a table tracing the distribution of parts of the Political Code into the Government Code. These attachments are:

Appendix A—Pol. C. Sec. 4041.18 (repealed 1947).

Appendix B—Govt. C. Sec. 25351, Sec. 25450, Sec. 25466.

Appendix C—Doctrines of implied contract *vel non*.

*Miller v. McKinnon*. [78]

Appendix D—Distribution and Derivation Table.

Comparison of these appendices will show that between 1942 and 1956, through adopting Govt. C. Sec. 23004 (c), Sec. 25351, Sec. 25450, Sec. 25450.5 and Sec. 25464, the legislature has entirely eradicated

all statutory basis for the harsh doctrine of the 1942 opinion in *Miller v. McKinnon*, *supra*, and restored to county public works contractors in California the humane doctrine of implied liability of a county for benefits received under a void express contract, quoted therein with approval from *Reams v. Cooley*, 171 Cal. 150, 152 Pac. 293, Ann. Cas. 1917A 1260 (1915).

Examination will also show that, through these same new Code sections, the legislature has expressly and/or impliedly authorized the making of public works contracts for smaller, split work orders or projects, free of the competitive bidding requirement, in the smaller counties of the state, including Orange County; and that such authorized splitting is also a modification of yet another former doctrine set forth in *Miller v. McKinnon*, *supra*.

In brief, these new or revised sections of the Government Code vest the county board of supervisors with plenary jurisdiction and general power, not limited expressly to any prescribed mode of procedure, to make contracts for the repair of hospital "buildings" (which includes the high steel water tank in question), together with plenary jurisdiction and general power to determine the "method of payment" therefor, with a prohibition against splitting limited to evasive splitting in counties containing 500,000 population or more. In addition to these changes, the amount of the board's contracting power without competitive bidding, has been increased to cover work projects estimated to cost

up to \$4,000.00. None of this power existed under Pol. C. Sec. 4041.18. It was conferred by the legislature, in the light of, and manifestly to ameliorate, the harsh doctrines of *Miller v. McKinnon*.

In view of these statutory changes since *Miller v. McKinnon*, that opinion lends no support whatever to the county's defense in this case. Rather, in view of those changes, it compels judgment for plaintiff on the pleadings herein.

The county is liable on the contracts, and is also estopped by the [79] warranty of legal compliance in the contracts, which the board approved, from claiming illegality. *Eyer (Geo. A.) Co. v. Mercer County*, 292 Fed. 292 (D.C. Ky. 1923) Affd. 1 Fed. 2d 609.

Freed by the new statute from the former rigid limitations on its power to contract, and vested with extensive new discretion as to methods of payment, etc., the board of supervisors is now charged with the power and duty of determining for itself and others, whether to resort to competitive bidding, the legal requirements for letting a particular contract, and whether it has complied therewith.

It would be extremely difficult or impossible, in view of the new discretion and power, for a contractor to determine such questions accurately, and at his peril, before submitting a bid, invited by the board, for county work. Hence, the county is estopped by the board's representation of full legal

compliance, from asserting its alleged irregularities as a defense here, under the rule laid down at length in *Gunnison County v. E. H. Rollins & Sons*, 173 U.S. 255, 19 S. Ct. 390, 43 L. Ed. 689 (1899).

Orange County is liable to plaintiff or the pleadings, whether or not it advertised for bids or adopted plans and working details, because:

1. The contracts for eight split work projects, each let at a separate price, were perfectly valid under Gvt. C. Sections 23004 (c), 25351, and 25464, since such contracts were exempt from the requirements of Gvt. C. Sections 25450 and 25450.5.

2. The county is also estopped to assert the alleged illegality of its contracts as a defense, because of the warranty of full legal compliance contained in said contracts, under *Gunnison County v. E. H. Rollins & Sons*, and *Eyer & Co. v. Mercer County*, *supra*.

3. It not so estopped, and even if the contracts are void, the county is yet liable to plaintiff in the same amount on implied contract under the humane doctrine of *Miller v. McKinnon*, *supra*, and cases therein cited, in view of the statutory changes.

In the alternative, the defendant Wills H. Warner is liable to plaintiff for a like amount as damages for the breach of his personal covenants in the [80] contracts, under Restatement of Agency, Sec. 332, and 2 Am. Jur. 250, Sec. 318.

The County is also liable to plaintiff for interest on the amount due, under the revised provisions of

California Civil Code Sec. 3287, which authorizes such interest against a county.

### Statement of the Facts

Orange County, California, contains less than 500,000 population. In 1956, the county's elevated steel water tank at the county hospital needed cleaning, repairing and painting. The extent of the welding necessary to make the repairs was unknown and could not be determined until the cleaning had been performed. Hence, working details for the repairs could not be prepared in advance of the cleaning. It was assumed that all the work would cost about \$6,500.00, but no full, legal estimate of the cost could be made until a part of the work had been performed.

In this situation, the Board of Supervisors authorized the County Purchasing Agent to arrange for doing the work in eight smaller work orders or projects, separately priced, as requested by the County Hospital Director.

The purchasing agent solicited bids by mail from five qualified business firms, for doing the eight work projects at separate prices. He received bona fide bids therefor from plaintiff and one other contractor. None of the eight items of work were bid at a figure exceeding \$1,000.00. The welding projects were bid by plaintiff at an item charge of \$0.60 per rivet, or \$3.50 per lineal foot, as required.

On October 2, 1956, plaintiff contracted with the board of supervisors to clean and paint the tank for



\$1,850.00, and to submit a flat-sum bid for the welding, after the required amount thereof should be determined by an inspection by the county, after the cleaning had been done. (Exhibit "D" to complaint, Par. 2.) The contract contained a warranty by the board's chairman that all legal requirements for letting the contract had been fully complied with. This indeed was true, as the total amount of that contract was only \$1,850.00, hence, less than \$4,000.00, and no advertising for bids or adopting of plans was required therefor. [81]

On October 5, 1956, the purchasing agent issued an order to plaintiff covering these and also two repair projects as to which plaintiff had bid flat sums, to wit, tightening and adjusting loose sway rods, \$150.00, and replacing catwalk plates where necessary, \$850.00; total \$,1000.00.

This \$1,000.00, added to the \$1,850.00 cleaning and painting contract of October 2, 1956, did not exceed \$4,000.00 and was well within the contracting power of the board of supervisors.

It was determined after the cleaning, upon inspection by the county, that 3,616 rivets needed welding, which at 60c per rivet, amounted to \$2,169.60. The cleaning also disclosed, upon such inspection, that the tank needed 712 lineal feet of seams welded, which at \$3.50 per lineal foot, amounted to \$2,492.00. These two amounts, added to the previous work orders totaling \$2,850.00, made the total cost of all eight work projects \$7,511.60. This amount was \$1,011.60 more than it had been

previously supposed the eight jobs of work would cost, but none of the individual projects let to plaintiff exceeded the \$4,000.00 contracting power of the board.

On November 7, 1956, the board entered into a written contract with plaintiff for the two welding projects, together with five projects already contracted for and substantially performed. This contract also contained the covenant that all legal requirements for letting the contract had been fully complied with. (Exhibit F, Par. 12.)

The Board also authorized an additional \$1,011.60 for the purchasing agent in arranging for performance of the eight work projects, thereby ratifying his prior order to plaintiff of October 5, 1956.

Plaintiff completed the work under all eight projects, to the county's satisfaction, on November 21, 1956, and submitted its bill therefor on November 24, 1956. (Exhibits "H" and "I" to complaint.)

Not having received payment under any of the contracts for any of the eight work projects, plaintiff on May 18, 1957, presented to the board four verified claims, based respectively on: (1) the three work projects covered by the contract of October 2, 1956, totaling \$1,850.00; (2) the two additional work projects covered by the purchase order of October 5, 1956, totaling [82] \$1000.00; (3) the two welding projects covered by the November 7, 1956, contract, totaling \$4,661.60; and (4) the total value of all the work, \$7,511.60, based on implied contract. The

board of supervisors rejected all four of these claims on May 28, 1957, and this suit is based on that rejection.

The contractual covenants that all legal requirements had been fully complied with in letting the contracts were, in terms, the personal covenants of defendant, Chairman Willis H. Warner, who signed the contracts for the board, under the express authorization from the board of supervisors that he sign those specific contracts containing those specific covenants, on the county's behalf.

The county's answer admits that it has accepted and is using plaintiff's work and does not intend to pay therefor; and that the reasonable value of plaintiff's work equals the contract amounts claimed in this action.

There is no claim nor pretense that there was any fraud or collusion on the part of plaintiff with anyone in securing and performing said contracts.

The county will pay nothing for any part of this work unless compelled to do so by this court.

## Legal Points and Authorities

### I.

#### The County Is Liable on Express Contracts

1. In the absence of some specific charter or statutory provision, municipal contracts need not be let under competitive bidding.

Davis v. City of Santa Ana,  
108 C.A. 2d 669, 239 P. 2d 656 (1952).

Swanton v. Cordy,  
38 C.A. 2d 227, 100 P. 2d 1077 (1940).

2. There is no specific provision in the present county public works act which forbids a county containing less than 500,000 population to split a public work into smaller work orders or projects to avoid the requirements of [83] competitive bidding. The only prohibition on this subject is that in Govt. C. Sec. 25450.5, against evasive splitting in the larger counties. In view of this expressly limited prohibition, under the rule *expressio unius est exclusio alterius*, such splitting is permitted in smaller counties.

23 Cal. Jur.,  
741, Sec. 118, n. 20.

Simth v. Eureka Flour Mills Co.,  
6 Cal. 1, 7 (1856).

Indeed, the new act gives county boards of supervisors general, plenary power to make contracts for the repair of hospital and other public buildings, and to determine the method of payment therefor, unrestricted to any particular mode of contracting. This includes discretion to split a public work into smaller work orders or projects, as conferred by the limited, express prohibition thereof in larger counties.

Govt. C.,  
Sections 23004 (c), 25351, 25450.5, 25464.

3. It is true that on the ground of "public policy," the court in *Miller v. McKinnon*, 20 Cal. 2d 83, 124 P. 2d 34, 140 A.L.R. 570 (1942) inferred a ban on all splitting under the former act. Pol. C. Sec. 4041.18, which act was wholly silent on the subject of splitting. However, the legislature has now expressly determined the limits of the prohibition, and thereby the state's public policy on this subject in Govt. C. Sec. 25450.5, and the judicial extension thereof is not justified.

50 Am. Jur.,  
214-216, Sec. 229.

4. Where a statute enumerates things upon which it is to operate, it is to be construed as excluding from its effect all those not expressly mentioned.

*Shelby v. Southern Pacific Co.*,  
68 C.A. 2d 594, 157 P. 2d 442, 445 (1945).

5. Primarily, it is for the legislature to determine the public policy of the state.

*Building Service Employees Int. Union, Local 262 v. Gazzam*, 339 U.S. 532, 536, 70 S. Ct. 784, 787, 94 L. Ed. 1045 (1949).

*Safeway Stores v. Reail Clerks Int. [84] Assn.*,  
41 Cal. 2d 567, 261 P. 2d 721 (1953).

The paramount public policy is that freedom to contract is not to be interfered with lightly. It is the court's duty to sustain the legality of a contract in whole or in part if it can do so.



Garcelon's Estate,

104 Cal. 570, 38 P. 414, 43 A.S.R. 134, 32 L.R.A. 574 (1894).

Andrews v. Horton,

8 C.A. 2d 40, 47 P. 296 (1935). 12 Am. Jur. 670-671, Sec. 172.

6. As no specific provision of law, and hence no public policy, was violated by the letting in Orange County of eight split work projects, each for a separate price under \$4,000.00, without formal competitive bidding, the tank work contracts were valid. This is certainly true as to the contracts of October 2 and 5, 1956 (Exhibits D and E to complaint) which, with welding expressly excluded as provided in Exhibit D, Sec. 2, covered only \$2,850.00 of work; and the above point of validity is pertinent, primarily, to the last contract, that of November 7, 1956, which included the welding projects.

7. The county itself is liable for interest from November 24, 1956, under the amended statute covering interest.

Civ. C. Sec. 3287.

## II.

The County Is Estopped to Claim the Law Was Violated

1. The Orange County Board of Supervisors had the legal power and discretion to determine the method of payment, and to split and let the tank work, with or without competitive bidding. It had

the legal power and the duty to adopt plans and working details and to advertise for bids, if it should decide to let the work without splitting; and it had the power to reject all bids, and do the work by day's work, if the bids submitted were too high. Finally, and in any event, it had the legal power and duty to determine for itself whether it had met all precedent legal requirements, and, based on its determination, to let the contract, or contracts, for the work. Also, the board has control of the county's defense in this action. [85]

Govt. Code Sections:

1st sentence: 25464, 25450, 25450.5.

2nd sentence: 25451, 25452, 25456.

3rd sentence: 23004 (c), 23005, 25351.

4th sentence: 25021, 25203.

2. Because of its power and duty to determine these matters, and because it would be extremely difficult or impossible for an outsider to ascertain the facts with certainty by normal inquiry, the county is estopped by an affirmative representation by the board that all legal requirements had been fully complied with in letting a public work contract.

Gunnison County v. E. H. Rollins & Sons,  
173 U. S. 255, 19 S. Ct. 390, 43 L. Ed. 689  
(1899).

3. The warranties of full legal compliance, made by the board chairman in executing the contracts of October 2, 1956, and November 7, 1956 (Exhibit D,

par. 10; Exhibit F, par. 12), were representations of the board, because the board had expressly authorized the chairman to sign, on its behalf, these specific contracts containing these specific warranties.

Eyer (Geo. H.) & Co. v. Mercer County,  
292 F. 292 (D. C. Ky., 1923), Aff'd. 1 F.  
2d 609.

4. The county is therefore estopped to claim the contracts are void for the board's alleged misfeasance in failing to properly advertise for bids in a newspaper or to adopt a working detail.

Gunnison County v. E. H. Rollins & Sons,  
*supra*.

### III.

#### The County Is Liable on Implied Contract

1. Under the rule in *Miller v. McKinnon* (Appendix C hereto), a county is liable on implied contract for the value of benefits received under an illegal express contract where:

(a) The board of supervisors is given general power [86] to contract with reference to the subject matter of the express contract;

(b) The manner of entering into the express contract, although irregular, was not violative of a specific statutory restriction on the general power, nor of public policy.

As shown under Point I above, all these conditions are met, in view of the new provisions of the Government Code.

Govt. C.

Secs. 25351, 25450, 25450.5, 25464, and  
23004 (c).

2. Deficient advertising for bids is such an irregularity as permits recovery of the value of benefits received.

*McCormick Lumber Co. v. Highland School District*, 26 C. A. 641, 147 P. 1183 (1915).

(This opinion was distinguished, not overruled, in *Miller v. McKinnon*, and is now a precedent of full vigor.)

3. Plans and working details, which cannot be determined in advance, or would be of no practical value, are not required. (The eight separate work items listed in Requisition M 2946A [Exhibit A to complaint] were sufficient as plans and working details for the letting in this case.)

*City Street Improvement Co. v. Kroh*,  
158 Cal. 308, 110 P. 933 (1910).

35 Cal. Jur.

2d 271, Sec. 478.

*Hodgeman v. City of San Diego*,  
53 C.A. 2d 610, 128 P. 2d 412 (1942).

4. Since bids from five qualified persons were solicited, and there was bona fide competitive bidding, the alleged irregularities in this case were not so grave as to bar relief on implied contract; and, indeed, in view of the broad new discretionary powers of the board of supervisors, there has never

been a reported case in California under which plaintiff would be denied relief against the county on the facts of this case. [87]

#### IV.

### Defendant Warner Is Liable for Breach of Covenant

1. An agent who expressly warrants the capacity of his principal to enter into a contract is liable for breach thereof.

Restatement of Agency, Sec. 332, Comment C.  
2 Am. Jur. 250, Sec. 318, n. 6.

#### Conclusion

The county is liable to plaintiff for \$7,511.60, with interest at 7% per annum from November 24, 1956, to date, on express or implied contract; and, in the alternative, defendant Warner is liable for \$7,511.60.

Respectfully submitted,

/s/ JAMES C. R. McCALL,

Attorney for Plaintiff. [88]

#### Appendix "A"

### Political Code Section 4041.18 (Repealed in 1947)

Powers of Supervisors. Buildings. (1) Under such limitations and restrictions as are prescribed by law, and in addition to jurisdiction and powers



otherwise conferred, the board of supervisors, in their respective counties, shall have the jurisdiction and powers to construct or lease, build or rebuild, furnish or refurnish or repair hospital and almshouse, courthouse, jail, historical museum, aquarium, county free library building, branch library building, art gallery, art institute, exposition building or buildings for exhibiting and advertising farming, mining, manufacturing, livestock raising, and other resources of the county, stadium and such other public buildings as may be necessary to carry out the work of the county government, and to provide all necessary officers, employees, attendants, and supplies for the proper maintenance of the same;

\* \* \*

Construction in Excess of \$500. Whenever the cost of construction of any bridge, wharf, chute, or other shipping facilities, or of any hospital, almshouse, courthouse, jail, historical museum, aquarium, county free library building, branch library building, art gallery, art institute, exposition building or buildings, stadium or other public buildings, or the cost of any repairs thereto or furnishing thereof shall exceed the sum of five hundred dollars, such work shall be done by contract, and any contract therefor shall be void unless the same shall be let as hereinafter provided.

Bids. The board of supervisors shall adopt plans and specification, strain sheets and working details therefor, and must advertise for bids for the per-

formance of the said work in a newspaper of general circulation published in the county. Such advertisement shall be published for at least ten consecutive times in a daily newspaper of general circulation published in the county or for at [89] least two consecutive times in a weekly newspaper published in the county. In case there is no newspaper in said county, then such notice shall be given by posting in three public places for at least two weeks.

Award. All bidders shall be afforded opportunity to examine such plans and specifications, strain sheets and working details, and said board shall award the contract to the lowest responsible bidder, and the person, firm or corporation to whom the contract shall be awarded must perform the work in accordance with the said plans and specifications, strain sheets and working details, unless the same be modified by a four-fifths vote of the members of the board of supervisors; and in every such case if the cost of the work be reduced by reason of the modification, compensation must be made to the county therefor, and the person, firm or corporation to whom the contract shall be awarded must execute a bond to be approved by the said board for the faithful performance of such contract;

Rejection of bids. Provided, that for the construction of any bridge, wharf, chute, or other shipping facilities, or any repairs thereto if the board of supervisors shall be advised by the county surveyor or engineer that the work can be done for a sum less than the lowest responsible bid, it shall then be their

privilege to reject all bids and to order the work done or structure built by day's work, under the supervision and direction of the said surveyor or engineer;

Emergency. Provided, further, that in case of great emergency, by the unanimous consent of the whole board, they may proceed at once to replace or repair any and all bridges and structures without adopting the plans and specification, strain sheets, or working details or giving notice for bids to let contract; the work to be done by day labor under the direction of the board, or by contract, or by a combination of the two; if wholly or in part by contract, the contractor [90] to be paid the actual cost of material and labor expended by him in doing the work, plus not more than fifteen per cent to cover all profits, supervision, use of machinery, and tools, and other expenses; provided, that no more than the lowest current market prices shall be paid for materials;

Purchasing agent. Provided, however, that in counties employing a purchasing agent, furnishings, materials and supplies used in the work mentioned in this subdivision costing not more than two thousand dollars, may be purchased by said purchasing agent in accordance with the provisions of section 4041.13 of this code without the formality of obtaining bids, letting contracts, preparing specifications and doing the other things required by this section for purchases costing more than five hundred dollars. [91]

Appendix "B"

Government Code Sections 25351, 25450-25466

(As amended, when Dixie work was done)

§ 25351. Construction and Repair of Buildings.

The board may construct, lease, build, rebuild, furnish, refurnish, or repair buildings for a hospital, almshouse, courthouse, jail, historical museum, aquarium, art gallery, art institute, exposition building for exhibiting and advertising farming, mining, manufacturing, livestock raising, and other resources of the county, stadium, and such other public buildings as are necessary to carry out the work of the county government. (Added Stats. 1947, c. 424, p. 1115, § 1, as amended Stats. 1951, c. 1681, page 3878, § 1.)

\* \* \*

§25450. Contract for Construction or Repairs

Exceeding \$4,000

Whenever the estimated cost of construction of any wharf, chute or other shipping facility, or of any hospital, almshouse, courthouse, jail, historical museum, aquarium, county free library building, branch library building, art gallery, art institute, exposition building, stadium, coliseum, sports arena or sports pavilion or other building for holding sports events, athletic contests, contests of skill, exhibitions, spectacles and other public meetings, or other public building or the cost of any repairs thereto exceeds the sum of four thousand dollars (\$4,000), in-

clusive of the estimated cost of materials or supplies to be furnished pursuant to Section 25457, the work shall be done by contract. Any such contract not let pursuant to this article is void. (As amended Stats. 1955, c. 327, p. 779, § 2; Stats. 1955, c. 1744, p. 3202, § 1);

§ 25450.4 Exception; Counties of 500,000 or over

In counties containing a population of 500,000 or over, the work referred to in Section 25450 need not be done by contract if the estimated cost thereof is less than four thousand five hundred dollars [92] (\$4,500), exclusive of the estimated cost of materials or supplies to be furnished pursuant to Section 25457. (As amended Stats. 1955, c. 1494, p. 2736, § 1.)

§ 25450.5 Splitting Work Under Contracts  
to Avoid Statute Prohibited

In any county containing a population of 500,000 or over, it is unlawful to split or separate into smaller work orders or projects any public work project for the purpose of evading the provisions of this article requiring public work to be done by contract after competitive bidding. Every person who willfully violates the provisions of this section is guilty of a misdemeanor. (As amended Stats. 1955, c. 1494, p. 2737, § 2.)

§ 25451. Plans and Specifications

The board of supervisors shall adopt plans, specifications, strain sheets, and working details for the work. (Added Stats. 1947, c. 424, p. 1121, § 1.)



§ 25452. Advertisements for Bids; Requisites  
of Publication

The board shall cause an advertisement for bids for the performance of the work to be published for at least 10 consecutive times in a daily newspaper, or for at least two consecutive times in a weekly newspaper, of general circulation published in the county. If there is no such newspaper published in the county, the notice shall be given by posting in three public places for at least two weeks. (Added Stats. 1947, c. 424, p. 1121, § 1.)

§ 25453. Examination of Plans and Specifications

All bidders shall be afforded opportunity to examine the plans, specifications, strain sheets, and working details. (Added Stats. 1947, c. 424, p. 1121, § 1.)

§ 25454. Award of Performance of Contract

The board shall award the contract to the lowest responsible bidder, and the person to whom the contract is awarded shall perform the work in accordance with the plans, specifications, strains, [93] sheets, and working details, unless the contract is modified by a four-fifths vote of the board. (Added Stats. 1947, c. 424, p. 1121.) \* \* \*

§ 25455. Faithful Performance Bond

The person to whom the contract is awarded shall execute a bond to be approved by the board for the faithful performance of the contract. (Added Stats. 1947, c. 424, p. 1121, § 1.) \* \* \*

§ 25456. Rejection of Bids and Performance  
by County

If the board of supervisors is advised by the county surveyor or engineer that any wharf, chute, or other shipping facility can be constructed or repaired for a sum less than the lowest responsible bid, it may reject all bids and order the work done by day's work under the supervision and direction of the surveyor or engineer. (Added Stats. 1947, c. 424, p. 1121, § 1.)

§ 25457. Purchase of Materials Costing Not More  
Than \$2,000 by Counties Employing Purchasing Agent

In counties employing a purchasing agent, furnishings, materials and supplies used in the construction or repair of any of the works mentioned in Section 25450 costing not more than two thousand dollars (\$2,000) may be purchased by the purchasing agent in accordance with Article 7 of this chapter<sup>1</sup> without the formality of obtaining bids, letting contracts, preparing specifications, and the other things required by the article for purchases costing more than two thousand dollars (\$2,000). (Added Stats. 1947, c. 424, p. 1121, § —, as amended Stats. 1947, c. 429, p. 1325, § 1; Stats. 1947, c. 970, p. 2238, § 3.)

\* \* \*

§ 25457.4 Purchase of Materials Costing Not More  
Than \$3,500 in Counties of 500,000 or More  
Population

In counties containing a population of 500,000 or

over and employing a purchasing agent, furnishings, materials and supplies to be used in the construction or repair of any of the works mentioned in [94] Section 25450 and estimated as costing not more than three thousand five hundred dollars (\$3,500) may be purchased by the purchasing agent in accordance with Article 7 of this chapter<sup>1</sup> without the formality of obtaining bids, letting contracts, preparing specifications, or the other things required by this article, and the estimated cost thereof shall not be considered or included in the estimate of the cost of construction for the purposes of Sections 25450 and 25450.4. (As amended Stats. 1955, c. 1494, p. 2737, § 3.)

\* \* \*

#### § 25458. Repair or Replacement of Structures in Emergency: Cost-Plus Contract

By the unanimous consent of the whole board in cases of great emergency, it may proceed at once to replace or repair any and all structures without adopting the plans, specifications, strain sheets, or working details or giving notice for bids to let contract. The work may be done by day labor under the direction of the board, by contract, or by a combination of the two. If the work is done wholly or in part by contract, the contractor shall be paid the actual cost of material and labor expended by him in doing the work, plus not more than 15 per cent to cover all profits, supervision, use of machinery and tools, and other expenses. No more than the lowest current

market prices shall be paid for materials. Added Stats. 1947, c. 424, p. 1121, § 1.)

\* \* \*

#### § 25459. Alteration of Plans

The plans and specifications adopted by the board for the erection, alteration, construction, or repair of any public building or other public structure shall not be altered or changed in any manner which increases its cost, except by a vote of two-thirds of the members of the board of supervisors. (Added Stats. 1947, c. 424, p. 1121, § 1.) [95]

#### § 25460. Alteration of Contract

Whenever the board enters into a contract for the erection, construction, alteration, or repair of any public building or other structure, the contract shall not be altered or changed in any manner, except by order adopted by a vote of two-thirds of the board, and the consent of the contractor. (Added Stats. 1947, c. 424, p. 1122, § 1.)

#### § 25461. Specification of Change

If any change or alteration of the contract is ordered, it shall be specified in writing and the cost agreed upon between the board and the contractor. If the cost so agreed upon:

(a) Does not exceed the amounts specified in Sections 25450 and 25457, or

(b) Does not exceed 10 per cent of the original contract price, the board may authorize the con-

tractor to proceed with the change or alteration without the formality of obtaining bids therefor.

No change or alteration shall be authorized the amount of which is within the limitation specified in subdivision (b) and in excess of the limitation specified in subdivision (a) except by four-fifths vote of the board. (Added Stats. 1947, c. 424, p. 1122, § 1, as amended Stats. 1949, c. 594, p. 1091, § 1; Stats. 1953, c. 1088, p. 2577, § 1.)

#### § 25462. Reduced Cost: Compensation

If the cost of the work is reduced by reason of any modification of the contract, compensation shall be made to the county therefor. (Added Stats. 1947, c. 424, p. 1122, § 1.)

#### § 25463. Extra Work or Material

The board shall not pay or become liable for any extra work done on, or extra material furnished for, any building or structure. (Added Stats. 1947, c. 424, p. 1122, § 1.)

#### § 25464. Determination of Method of Payment

The method of payment for construction contracts shall be determined by the board, including progress payments for completed portions of the work and for materials delivered on the ground or [96] stored subject to the control of the board and unused. (Added Stats. 1951, c. 1233, p. 3078, § 1.)



§ 25466. Changes in Construction Contracts;  
Requisites; Restrictions on Amount

The board of supervisors may, by board order, authorize the county engineer, or other county officer, to order changes or additions in the work being performed under construction contracts. When so authorized, any change or addition in the work shall be ordered in writing by the county engineer, or other designated officer, and the extra cost to the county for any change or addition to the work so ordered shall not exceed five hundred dollars (\$500) when the total amount of the original contract does not exceed fifty thousand dollars (\$50,000), nor 1 per cent of the amount of any original contract which exceed fifty thousand dollars (\$50,000). In no event shall any such change or alteration exceed four thousand five hundred dollars (\$4,500). (Added Stats. 1953, c. 1203, p. 2723, § 1.) [97]

Appendix "C"

Rule Allowing Recover on Quantum Meruit by Contractor When Municipal Corporation's Public Works Contract Is Void for Irregular Procedure in Letting the Same.

Quoted From:

Reams v. Cooley,  
171 Cal. 150, 152 Pac. 293,  
Ann. Cas. 1917A 1260 (1915)

Miller v. McKennon,

20 Cal. 2d 83, 124 P. 2d 34,

140 ALR 570 (1942)

\* \* \*

“Undoubtedly a school board, like a municipal corporation, may, under some circumstances, be held liable upon an implied contract for benefits received by it, but this rule of implied liability is applied only in those cases where the board of municipality is given the general power to contract with reference to a subject matter, and the express contract which it has assumed to enter into in pursuance of this general power is rendered invalid for some mere irregularity or some invalidity in the execution thereof, and where the form or manner of entering into a contract is not violative of any statutory restriction upon the general power of the governing body to contract nor violative of public policy. In the absence of such restriction on the mode or manner of contracting, the same general rule applies to such inferior political bodies as to individuals, and the former will be held responsible on an implied contract for the payment of benefits it receives under an illegal express contract not prohibited by law. This is the effect of the cases cited by appellant and relied on by him. \* \* \* But while the doctrine of implied liability applies where general power to contract on a subject exists and the form or manner of doing so is not expressly provided by charter or statute, the decided weight

of authority is to the effect that, when by statute the power of the board or municipality to make a [98] contract is limited to a certain prescribed method of doing so, and any other method of doing it is expressly or impliedly prohibited, no implied liability can arise for benefits received under a contract made in violation of the particularly prescribed statutory mode. Under such circumstances the express contract attempted to be made is not invalid merely by reason of some irregularity or some invalidity in the exercise of a general power to contract, but the contract is void because the statute prescribes the only method in which a valid contract can be made, and the adoption of the prescribed mode is a jurisdictional prerequisite to the exercise to the power to contract at all, and can be exercised in no other manner so as to incur any liability on the part of the municipality. Where the statute prescribes the only mode by which the power to contract can be exercised, the mode is the measure of the power.” [99]

## Appendix “D”

### Distribution of Political Code in Government Code, and New Sections in the Latter

Political Code Sections material to this case were distributed in the new Government Code in 1947 as follows:

	Pol. C. Sec.	
Subject:	Par. & Sent.	Govt. C Sec.
Power to make contracts.....	Sec. 4003(3)	23004(c)
Contracting agents. ....	.....	23005
	Paragraph (1)	
	Sec. 4041.18	
Jurisdiction to repair. ....	Sent. 1	25351
Competitive Bidding. ....	Sent. 2	25450
Bids: Advertisement, plans. ....	Sent. 3	25451-25452
Award: Bond, altering plans. ..	Sent. 4	25453-25455, 25459-25460, 25463.
Rejection; Emergency. ....	Sent. 5	25456, 25458
Purchasing Agent. ....	Sent. 6	25457

Material new Government Code Sections never in the Political Code are:

Subject:	Govt. C. Sec.
Increased competitive bidding exemption for large counties. ....	35450.4
Splitting prohibited in large counties. ....	25450.5
Determination of Methods of Payment. ....	25464
Payment for extra costs. ....	25466

Affidavit of service by mail attached.

[Endorsed]: Filed November 14, 1957. [100]

[Title of District Court and Cause.]

## NOTICE AND MOTION FOR JUDGMENT ON THE PLEADINGS IN FAVOR OF PLAINTIFF

To the Defendants Above Named and to Their Attorneys:

Notice Is Hereby Given that on December 16, 1957, at 10:00 o'clock a.m. of that day, or as soon

thereafter as counsel can be heard, before the Honorable Leon R. Yankwich, Judge, in the above-entitled Court, plaintiff, Dixie Tank & Bridge Co., will move the Court for a judgment for plaintiff on the pleadings, pursuant to F.R.C.P. Rule 12.

The ground of the motion will be that the answer of the defendants and their admissions of record show that plaintiff is entitled to judgment as prayed. The motion will be based on defendants' admissions of record and plaintiff's memorandum of points and authorities on motions for judgment heretofore filed.

Dated: November 25, 1957.

/s/ JAMES C. R. McCALL,  
Attorney for Plaintiff.

Affidavit of service by mail attached.

[Endorsed]: Filed November 26, 1957. [102]

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[Title of District Court and Cause.]

AFFIDAVIT OF W. A. RILEY  
(On Motions for Judgment)

State of Tennessee,  
County of Shelby—ss.

I, W. A. Riley, on oath, depose and say:

I reside in Memphis, Tennessee, and am the President of Dixie Tank & Bridge Co., the above-



named plaintiff, the office of which is also in Memphis, Tennessee. I have continuously held that office for many years last past, including 1956.

On or about September 1, 1956, I received, as President, at the company's office in Memphis, Tennessee, a "Request for Bid" from the Purchasing Agent of Orange County, California; and, pursuant to the instructions printed thereon (as I understood such instructions), I filled out said Request, as a bid for the company, by inserting therein flat sums, or total prices, for five (5) separate items of work therein listed, and unit or [104] piece work prices for three (3) other separate items of welding work therein listed, the total amount of which welding work was then unknown. After signing this request for bid, so filled out as the Company's bid, on September 4, 1956, I transmitted such bid to the purchasing agent for Orange County, California.

A true copy of this request and bid is attached as Exhibit B to the Second Amended and Supplemental Complaint on file in the above-entitled action. Said Exhibit B is incorporated in this affidavit by this reference. The bid provided:

"We have stated hereon the prices at which we will furnish the articles or services as specified."

The nature of the tank work was such that no total price for all eight (8) separate work items listed in the request, could be computed at that time, since the amount of welding needed was unknown and could not be determined before the

cleaning had been performed. No total price for all the tank work was asked for or computed at that time; and, of course, no total price for all eight items of work was computed or bid by Dixie Tank & Bridge Co. I had no knowledge at the time what welding would be needed; and I had no knowledge or belief that the separation of the total work into eight projects separately listed at separate prices could be deemed legally irregular in any respect, as that is what the request called for.

I submitted this bid in good faith as a competitive bid, believing that the County was requesting competitive bids for the various work items.

Dixie Tank & Bridge Co. has been engaged in the elevated tank repair business for many years, in many different states of the United States. It has prepared, and generally uses, a uniform set of contracts for such work. These form contracts are printed, and copies thereof were used in the Orange County matter. They appear as Exhibits D and F to the Second Amended and Supplemental Complaint on file in the above-entitled action, and as such exhibits, are incorporated in this affidavit by this reference.

The initial contract (Exhibit D) provides only for cleaning, scaling, inspecting and painting a tank for a flat price; and expressly provides that [105] after the cleaning, and inspection by the tank owner's inspectors will be made "to determine what, if any, repairs are necessary," and that:

“After tank has been inspected, company will submit a flat sum bid for all such repairs as may be necessary. This bid will be submitted \* \* \* and a written repair contract embodying the specific work to be done, and the entire price to be paid, shall be entered into \* \* \* before any repair work is done.”

The second contract (Exhibit F) expressly covers the repairs agreed upon, after cleaning and inspection, at a flat sum. It also provides in Paragraph 8 that upon payment for the work on the tank, a written warranty will be issued by the company, warranting the painting for three years and the repair work for twelve years after completion of the work.

These contracts (Exhibits D and F) clearly (and necessarily) divide the work into separate parts at separate prices, to wit, (1) cleaning and painting, and (2) repairing. The business of elevated steel tank repairing could not be rationally, justly and satisfactorily conducted without such separation.

The cleaning, painting and repairing of elevated steel tanks involves the transportation and use at the tank site of much expensive rigging, tooling and machinery. The rental or use of such equipment cannot be compensated for within the restrictive formula for payment for emergency repairs (on a cost-plus 15% basis) specified in Government Code Section 25458; and affiant refused to undertake repair of the Orange County hospital tank as an emergency work on a cost-plus basis, before affiant

received the County's request for bid of September 1, 1956, aforesaid.

At the Orange County Purchasing Agent's request, on September 21, 1956, I signed and sent to said Agent the company's usual cleaning, scaling, inspecting and painting contract, the execution of which was duly authorized by the Board of Supervisors on October 2, 1956. (See Exhibit D to the Second Amended and Supplemental Complaint.) This contract contained a covenant by the executing official that he was authorized to sign the same and that all [106] legal requirements had been fully complied with.

I relied upon this covenant in performing said contract of October 2, 1956.

A similar covenant was a part of the usual form of repair contract which the Board of Supervisors authorized on November 7, 1956. (Exhibit F to the Second Amended and Supplemental Complaint.)

I relied upon this covenant in performing the second contract.

On November 21, 1956, the company had completed all its work on all eight items, and the work had been accepted by the County's representative in charge thereof, who, on that day, recommended that payment be made to the company according to the contract (See Exhibit H to Second Amended and Supplemental Complaint).

A day or two after November 21, 1956, I received, in the form of a letter from the office of the County

Counsel of Orange County, the first intimation of any claim that the Board of Supervisors had acted in any way irregularly in the matter. In this letter, the office of the County Counsel proposed that I sign for the company yet another contract agreeing to do the work on a cost-plus basis as an emergency project under Government Code Section 25458 (which I had previously refused to do), and that the company submit an itemized statement of its actual expenses, excluding anything for the transportation and use of the rigging, tooling and machinery which had been necessarily used in performing the contract, and agree to accept such partial amount of expenses, plus 15% thereon, in full settlement for all the company's work on the tank, limited, however, to \$7,511.60 (which was the total of all of the separate work items covered by the contracts).

The reason for the proposed new and different contract was stated in the letter to be: "The law of California which does not permit the County to perform work of this nature without advertising for bids for the total cost exceeds \$4,000.00, except in cases of great emergency."

Affiant, for the company, rejected this proposal.

Affiant considered and believed, the request for bid to be an "advertising for bids," and affiant's company had bid competitively in [107] response thereto. The company would lose money on the job, on the restrictive payment formula proposed, and



had previously refused to bid for the work on a cost-plus basis. Further, the company, in accepting the work, had relied upon the covenants in the contracts approved by the Board of Supervisors that all legal requirements had been fully complied with. Finally, there is nothing in the California law which prevents the letting of the smaller work projects at separate prices in Orange County, as the Board did in this case, according to affiant's understanding and belief, based on legal advice.

For each of these reasons, affiant refused to sign the proposed new contract, and, due to lapse of time, affiant understands that the company will never receive anything from the County for its work, except through this action for recovery of just compensation on express or implied contract, or through estoppel.

Affiant's company in good faith bid and contracted for, satisfactorily performed, and separately billed the County for separate items of work (Exhibit I), as follows:

Scaling, cleaning and painting interior and exterior of tank, labor and materials . . . .	\$1,850.00
Welding 712 feet seams at \$3.50 per lineal foot . . . . .	2,492.00
Welding 3,616 rivets at \$0.60 per rivet . . . .	2,169.60
Tighten and adjust all loose sway rods . . .	150.00
Replace catwalk plates where necessary . . .	850.00
<hr/>	
Total . . . . .	\$7,511.60

Dated: November 29, 1957.

/s/ W. A. RILEY,  
Affiant.

Sworn to and subscribed before me November 29th, 1957.

[Seal] /s/ H. I. BLOODWORTH,  
Notary Public in and for  
Shelby County, Tennessee.

My Commission Expires Oct. 9, 1960.

[Endorsed]: Filed December 3, 1957. [108]

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[Title of District Court and Cause.]

NOTICE AND MOTION FOR SUMMARY  
JUDGMENT IN FAVOR OF PLAINTIFF  
(F.R.C.P. RULE 56)

To the Defendants Above Named and to Their  
Attorneys:

Notice Is Hereby Given that on December 23, 1957, at 10:00 o'clock a.m. of that day, or as soon thereafter as counsel can be heard, before the Honorable Leon R. Yankwich, District Judge, in the above-entitled Court, plaintiff Dixie Tank & Bridge Co., will move the Court for a Summary Judgment for plaintiff, pursuant to F.R.C.P. Rule 56, and Local Rule 3(d)(2).

The ground of motion will be that there is no genuine issue as to any material fact, and that the

plaintiff is entitled to a judgment against defendant County of Orange, or in the alternative against defendant Willis H. Warner, as a matter of law.

The motion will be based on the entire record on file in the case, and especially on the Second Amended and Supplemental Complaint, the Answer [110] thereto, Plaintiff's Request for Admissions, and the defendants' admissions made pursuant thereto, together with the affidavit of W. A. Riley on file herein; and on Plaintiff's Memorandum on Motions of Judgment.

Plaintiff has served with this Notice, proposed Findings of Fact and Conclusions of Law, and proposed Summary Judgment.

Dated: December 10, 1957.

/s/ JAMES C. R. McCALL,  
Attorney for Plaintiff.

Affidavit of service by mail attached.

[Endorsed]: Filed December 11, 1957. [111]

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[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS  
OF LAW  
(Proposed)

This case came on to be, and was, heard on December ..., 1957, before the Honorable Leon R. Yankwich, on motion of the plaintiff for summary

judgment in its favor, based on the entire record on file herein; and said motion having been argued and submitted by the parties, through their attorneys, and the Court being fully advised in the premises, makes the following

### Findings of Fact

#### I.

Through its Second Amended and Supplemental Complaint, plaintiff Dixie Tank & Bridge Co., a corporation, seeks judgment on contract, both express and implied, against the defendants County of Orange, a California County, and Willis H. Warner, for the agreed and actual value of work performed by plaintiff on a water tank, the property of the County. The County [113] contends that the contracts for the work were ultra vires because of alleged irregularities of its Board of Supervisors in letting the same. Plaintiff (called "Dixie" herein) denies that there were any such irregularities and further contends the County is estopped to rely thereon by reason of covenants of the Board appearing in the contracts, that all legal requirements had been fully complied with. This covenant is made by the persons signing the contracts on behalf of the County; and is the basis of plaintiff's action against defendant Warner, who signed the contracts as Chairman of the Board, by the Board's express authorization. Dixie seeks judgment against Warner personally, for damages for breach of this covenant, in the event that it should be denied

judgment, in whole or in part, against the County because of the Board's asserted irregularities.

## II.

Dixie is a citizen of the State of Tennessee; and the two defendants are citizens of the State of California. The defendant County contains a population of less than 500,000. During 1956 its population was 216,224 as determined by a California Statute, Gov. C., Sec. 28020. Defendant Warner, during 1956, was, and now is, the Chairman of the Board of Supervisors of the County.

## III.

The water tank in question is a 100,000-gallon elevated steel tank, standing on the grounds, and constituting a part of the plant, of the Orange County General Hospital, near Orange, California. In and by a series of three written contracts entered into by the County and Dixie between October 2, 1956, and November 7, 1956, the County employed Dixie to furnish the necessary labor and material, and to clean, repair and paint the inside and outside of the tank, and to tighten and adjust the sway rods and replace catwalk plates, on the tank.

## IV.

The tank work was divided by the County in the contracts, and in the hospital's requisition for the work, and in the County's request for bids, into eight (8) separate projects or items of work, each



to be done and performed [114] for a separate agreed price. These projects and the prices finally agreed upon between the County and Dixie were as follows (an identifying number being assigned to each separate project or work item, for later reference thereto herein), to wit:

Project		Contract
No.	Description of Project	Price
1	Rig, scale and clean inside of tank with scaling machine to clean metal. ....	\$ 550.00
2	Weld all rusted out rivets (3,616 at 60 cents each).	2,169.60
3	Weld all deteriorated seams (712 feet at \$3.50 per foot). ....	2,492.00
4	Weld all pits in tank plates that are over halfway through tank plates (none at 60 cents each).....	
5	Tighten and adjust all loose sway rods. ....	150.00
6	Prime and reline interior of tank. ....	650.00
7	Remove loose rust and paint from exterior of tank and tower, and spot prime and repaint exterior of tower and tank. ....	650.00
8	Replace catwalk plates where necessary. ....	850.00

# V.

Dixie performed all items of work on the tank to the County's satisfaction, completing the same on November 21, 1956; and on that date the County's representative in charge of the work accepted the same for the County and recommended payment by the County of the agreed prices to Dixie. On November 24, 1956, Dixie submitted its bill for the various projects or work items, totalling \$7,511.60, to the County, which on November 21, 1956, re-

ceived, and has ever since been in possession of and using, the cleaned, repaired and repainted tank.

## VI.

The labor and materials furnished by Dixie, and consumed by it in performing the tank work, were of the reasonable worth and value of \$7,511.60; and the reasonable worth and value of the labor and material furnished and consumed by Dixie in performing each of the separate projects [115] or work items was the agreed contract price therefor hereinabove listed.

## VII.

The County, acting through its Board of Supervisors, has failed and refused ever since November 24, 1956, to pay Dixie anything whatever for the work. Dixie unsuccessfully negotiated with the County for payment from November 24, 1956 to May 18, 1957; and on the latter date filed with, and presented to the Board of Supervisors of the County four verified claims for payment for the work. Three of the claims were based on the written contracts therefor; the fourth claim was quantum meruit for the reasonable value of the labor and material furnished in performing the work. On May 28, 1957, the Board of Supervisors denied and rejected each of these four claims, and this action is based on such rejection.

## VIII.

The Board of Supervisors is in control of the County's defense to this action, and it contends in

the answer that the County is not liable to Dixie on either express or implied contract because of the following alleged irregularities of the Board (which the defendants claim were violations of Secs. 25451 and 25452 Gov. C.), to wit:

(1) The Board allegedly failed to "adopt plans, specifications, strain sheets and working details for the work"; and

(2) The Board failed to "cause advertisement for bids for the performance of the work to be published in a newspaper of general circulation published in the county."

These defenses require findings as to the steps by which the contracts were let and performed.

## IX.

On August 23, 1956, the Director of the Orange County General Hospital filed with the Purchasing Agent of said County Requisition No. M2946A for repair of the tank, divided into the eight projects or work items listed in Paragraph IV above. This Requisition was transmitted by the hospital committee of the Board of Supervisors to the Board, with the recommendation that the Purchasing Agent be authorized "to arrange" for making [116] these specific repairs. On August 26, 1956, the Board, at a regular meeting, unanimously adopted a motion authorizing the Purchasing Agent "to arrange for the repair of the high tank at the Orange County Hospital, as requested by R. D. Powell, Orange County Hospital Director" in said Requisi-

tion. It was estimated that all eight projects would cost about \$6,500.00, but no estimate of the individual projects or work items, was made except that the cost of rigging, scaling, and cleaning the inside of the tank (Project 1 in the above list) was estimated at \$585.00. The amount of welding necessary to repair the tank was unknown and could not be determined until Project 1 had been completed. Later, on November 7, 1956, the Board appropriated an additional \$1,011.60 for the Purchasing Agent, to cover the then ascertained cost of all eight projects or work items, thereby ratifying the Purchasing Agent's "arrangements" made under the authority of August 28, 1956.

## X.

Pursuant to his authority, the Purchasing Agent, on August 31, 1956, mailed a uniform Request for Bid to five contractors, including Dixie, listing therein the eight projects or work items hereinabove described, and requesting unit prices with extension and total price as to each project or work item. The request reserved to the County the right to reject any and all bids; and required that all bids be returned to the Purchasing Agent by September 18, 1956. The names and addresses of the contractors so solicited for bids were as follows:

Pacific Brick & Tank Coating Co., 1051 E. Wardlow Rd., Long Beach, Calif.

Pittsburgh-Des Moines Steel Co., P.O. Box 2012, El Monte, California.

Dixie Tank & Bridge Co., P.O. Box 1,  
Memphis 1, Tennessee.

Pittsburgh Tank & Tower Co., c/o M. C.  
Mattis, 861 S. Palm, Anaheim, California.

West Coast Corrosion Engineering Corp.,  
c/o D. N. Sullivan, Box 1164, Santa Ana,  
California.

## XI.

In response to this solicitation, two bids were submitted, each listing a separate price for each of the eight projects or work items; one bid [117] was by Dixie, and the other was filed by E. R. Waites in response to the solicitation of the Pittsburgh Tank & Tower Co. The Waites bid was withdrawn on September 18, 1956. Dixie's President, W. A. Riley, understood the request for bid as calling for separate bids for each separate project or work item, and in good faith submitted Dixie's bid as a competitive bid on that basis.

## XII.

On September 19, 1956, the Purchasing Agent by letter inquired of Dixie concerning its inspection service and guarantee of tank work for a period of years after its performance thereof. In answer, Dixie signed and forwarded to the Purchasing Agent, on September 21, 1956, a contract for cleaning, scaling and painting the tank, covering Projects 1, 6 and 7 hereinabove listed, for a price of \$1,850.00 (which was the total of its three separate bids for said three projects, to wit, \$550.00,



\$650.00, and \$650.00, respectively). On October 2, 1956, this printed form contract so signed by Dixie was reported to, and placed before, and considered by the Board of Supervisors at a regular meeting thereof, and by unanimous vote the Board adopted a motion to approve that particular contract, and authorized the Chairman of the Board to sign the same, which the Chairman did on the same day. This contract of October 2, 1956, provided that for \$1,850.00, Dixie would rig, clean and scale the inside of the tank for inspection by the County, and that after the tank had been so inspected following such cleaning, plaintiff would submit a flat sum bid for the repairs to the tank, revealed thereby as necessary, and that thereafter a written repair contract for specific repair work, and the entire price to be paid therefor, would be entered into between Dixie and the County before any such repairs would be made. The contract also contained, in Paragraph 10 thereof, the following covenant:

“Parties signing this contract in behalf of first party (the County) covenant and agree that they are fully authorized and empowered to sign, seal, and deliver and execute the same and that all legal requirements have been fully complied with.” [118]

### XIII.

On October 5, 1956, the County Purchasing Agent notified Dixie of the execution of the contract of October 2, 1956, for \$1,850.00, and also sent to Dixie the County's Order No. 62659, which was, in terms, an order for the performance of the eight projects

or work items at the separate prices bid therefor by Dixie, in response to the solicitation for bids. In this Order No. 62659, as well as in Dixie's bid, no contract price was quoted for the welding covered by Projects 2, 3 and 4 above listed, other than the unit prices for welding each rusted-out rivet and deteriorated seam and pit. No total price therefor could be quoted because the extent of such welding was unknown and could not be ascertained until the cleaning had been done. The unit prices of 60 cents each for welding rivets and pits, and \$3.50 per lineal foot for welding deteriorated seams were stated in the bid and the Order of October 5, 1956. This Order had the effect of adding Projects Nos. 5 and 8 above listed, to wit, tightening and adjusting loose sway rods for \$150.00, and replacing catwalk plates where necessary for \$850.00 (total \$1,000.00) to the contract price of \$1,850.00 for the three projects covered by the contract of October 2, 1956, aforesaid; and of leaving for future determination and bidding the doing of the three welding projects or work items.

#### XIV.

Dixie rigged, cleaned and scaled the tank under the contract of October 2, 1956, followed by the County's inspection, which revealed that there were 3,616 rusted-out rivets and 712 lineal feet of seams which needed welding. Dixie agreed to weld these rivets and seams at the unit prices stated in its bid. On November 7, 1956, at a regular meeting of the Board of Supervisors, another contract on a printed form, specifying this number of rivets to be welded

at the agreed blanket price of \$2,169.60, and this number of lineal feet of seams to be welded at the agreed blanket price of \$2,492.00, was presented to, and considered and approved by the Board of Supervisors which, by unanimous vote, adopted a motion authorizing the Chairman to sign this particular contract with Dixie, which was done on the [119] same day. This contract fixed the price for all the work done, or to be done, by Dixie on the tank, at \$7,511.60, which is the total of the various contract prices hereinabove listed, including those prices for the five projects (Projects Nos. 1, 5, 6, 7 and 8) which had theretofore already been contracted for and substantially performed by Dixie for the agreed total price of \$2,850.00. This contract of November 7, 1956, contained in Paragraph 12 thereof the following:

“The party or parties signing this contract on behalf of the first party (the County) covenant and agree that they are fully authorized to sign, execute and deliver the same, and that all legal requirements have been fully complied with.”

#### XV.

On November 13, 1956, Dixie was informed of the Board's execution of the contract of November 7, 1956, and the Purchasing Agent on the same date issued to Dixie a change order for additional labor and material in the sum of \$1,011.60, as authorized by the Board of Supervisors in adopting, on November 7, 1956, another motion which authorized the Purchasing Agent such additional amount. Dixie

thereupon promptly proceeded with and completed all the work, to the County's satisfaction, on November 21, 1956.

#### XVI.

In entering into and performing the contracts, Dixie reasonably believed, and in good faith relied on the covenants contained in the aforesaid contracts of October 2, 1956, and November 7, 1956, that all legal requirements had been fully complied with by the Board; and Dixie would be inequitably and irreparably damaged if the Board and County were now permitted to rely upon and prove the Board's claimed irregularities as a means of enabling the County to avoid paying for Dixie's work. The Board, through and with its Chairman, were the "parties signing this contract on behalf of the County," within the meaning of said covenants.

#### XVII.

The tank work was divided and let to Dixie with the knowledge, [120] consent, approval and participation of the Board of Supervisors in eight smaller projects or work orders. Each was let and performed for a separate agreed price; and Dixie would be inequitably and irreparably damaged if the Board and County were now permitted to contend, as a means of avoiding payment for Dixie's work that, in fact, the eight projects or work items constituted but one project undertaken for a single price. None of said eight projects were estimated to cost, or did cost, more than \$4,000.00.



## XVIII.

The purpose of the Board of Supervisors in authorizing the signing, and in entering into the contracts with Dixie was not to evade the provisions of Article 5, Chapter 5, Part 2, Division 2, Title 3, of the Government Code of California. The work was reasonably, naturally, and necessarily split or divided into smaller work orders or projects because the nature and amount of the welding necessary to repair the tank was unknown, and could not be ascertained, until the cleaning and scaling work had been done. The descriptions of the eight projects approved by the Board in adopting Requisition No. M2946A, were sufficient "plans, specifications, strain sheets, and working details for the work," within the meaning of Government Code Sec. 25451.

## Conclusions of Law

Based on the foregoing Finds of Fact, the Court concludes, as a matter of law:

1. That the Board of Supervisors was vested with power under Government Code Secs. 23004 (c), 23005, 25351, and 25464, to divide or separate the tank repair work into smaller work orders or projects, estimated to cost less than \$4,000.00 each, and to let such smaller work orders or projects to Dixie, without complying with the newspaper advertising, and plans and specification requirements of Government Code Secs. 25451 and 25452; and that such splitting was not prohibited by Government Code Secs. 25450 and 25450.5.



2. That the contracts between Dixie and the County were valid, [121] and not ultra vires.

3. That the County is estopped by the covenants of the Board of Supervisors contained in the contracts with Dixie, executed October 2, 1956, and November 7, 1956, that all legal requirements had been fully complied with, to contend or show that the Board failed to adopt plans and working details or to advertise for bids in a newspaper.

4. That even if said written contracts were invalid for such alleged irregularities of the Board, the County would be, and is, liable to Dixie for the reasonable value of its work, and material, under implied contract; and that such liability is in the same amount as the amount due under the contracts, since the value of the labor and material equalled the contract prices therefor.

5. That the County is liable to Dixie for the sum of \$7,511.60, whether by express or implied contract, or by estoppel, together with interest thereon at the rate of seven per cent (7%) per annum from November 4, 1956, to date of judgment, pursuant to the provisions of Sec. 3287 of the Civil Code of California.

6. That as a member and agent of the Board of Supervisors, defendant Willis H. Warner would be liable to Dixie for breach of the covenant that all legal requirements had been fully complied with, if the defendant County were not liable.

## Directions for Judgment

Let plaintiff's counsel prepare and submit a draft of judgment in favor of Dixie, and against the County, for the sum of \$7,511.60, with interest as aforesaid, and costs, and for judgment dismissing the action as to defendant Willis H. Warner.

Dated: December . . . ., 1957.

.....

United States District Judge.

Lodged: December 11, 1957.

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[Title of District Court and Cause.]

## SUMMARY JUDGMENT

(Proposed)

This cause came on to be, and was heard, on December . . . ., 1957, before the Honorable Leon R. Yankwich, District Judge, in the above-entitled Court, on motion by plaintiff for summary judgment against the defendants; and said motion having been presented, argued and submitted by counsel for the parties, and the Court being fully advised in the premises, and having made and entered its Findings of Fact and Conclusions of Law:

It Is Ordered, Adjudged and Decreed by the Court:

That plaintiff Dixie Tank & Bridge Co. have, and recover of and from the defendant County of

Orange the sum of \$7,511.60 with interest thereon, at the rate of seven per cent (7%) per annum from November 24, 1956 to date hereof, together with plaintiff's costs incurred herein; and that the complaint be dismissed with his costs as to defendant Willis H. Warner.

Dated: December . . . ., 1957.

.....

United States District Judge.

Lodged December 11, 1957. [123]

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[Title of District Court and Cause.]

RESPONSES TO REQUESTS  
FOR ADMISSIONS

State of California,  
County of Orange—ss.

Affidavit

Defendant Willis H. Warner being first duly sworn, deposes and says that the statements made in Plaintiff's "Request for Admissions" are true, not true, or not true in part as follows:

"1. In 1956, Orange County, California, contained a population of less than 500,000; and, by Government Code Section 28020, its population was ascertained and determined to be 216,224."

1. Paragraph 1 is true.

“2. The County Purchasing Agent sent out uniform requests for bids on the tank work to five firms, each request containing the printed and typewritten [124] matter shown on Exhibit C to the Second Amended and Supplemental Complaint, but with nothing in the columns headed ‘Unit Price’ and ‘Total’; and the bidders filled out the matter in those two columns as shown on Exhibits B and C.”

2. Paragraph 2 is true, except that only two bidders responded to the request for bids, as alleged in Plaintiff’s Second Amended and Supplemental Complaint, Paragraph XI, Subparagraph 3.

“3. Dixie Tank & Bridge Co. on or about September 21, 1956, signed the ‘Contract for Cleaning, Scaling, Inspecting and Painting,’ (Exhibit D to the Second Amended and Supplemental Complaint). This contract, so signed by Dixie, was the contract referred to in the minutes of the meeting of the Board of Supervisors of Orange County on October 2, 1956, which minutes are quoted on Page 9 of the Second Amended and Supplemental Complaint; and Chairman Warner signed this specific contract on this same day pursuant to the quoted authority.”

3. Paragraph 3 is true.

“4. The \$1,850.00 contract price fixed in this contract of October 2, 1956, was the total of

the following three items bid for the same work in plaintiff's bid (Exhibit F), and in the County Purchasing Agent's order No. 62659, dated October 5, 1956, to wit:

"Rig, scale and clean inside of tank with scaling machine to clean metal .....	\$ 550.00
"Prime and reline interior of tank	650.00
"Remove loose rust and paint from exterior of tank and tower and spot prime and repair [125] ex- terior of tower and tank.....	650.00
<hr/>	
Total .....	\$1,850.00"

4. Paragraph 4 is true, except the Exhibit is B, not F.

"5. The contract of November 7, 1956 (Exhibit F to the Second Amended and Supplemental Complaint), is the contract referred to in the minutes of the meeting of the Board of Supervisors on November 7, 1956, which minutes are quoted on Page 11 of such pleading; and Chairman Warner signed this contract on the same date, pursuant to this quoted authority."

5. Paragraph 5 is true.

"6. The purpose of the Board of Supervisors in authorizing the signing of the contracts with Dixie Tank & Bridge Co. on October 2, 1956 and November 7, 1956, was not



to evade the provisions of Article 5, Chapter 5, Part 2, Division 2, Title 3 of the Government Code. The purpose was to secure specific bids for specific parts of the work, in order that the County might perform by day's work such parts thereof for which the bids received might be too high, in the opinion of the proper County officials, and to secure piece-work bids for the welding that might be determined to be necessary, after the cleaning had been performed."

6. The first sentence of Paragraph 6 is true. The second sentence of said paragraph is not true.

"7. On October 2, 1956 and November 7, 1956, the Board of Supervisors had before it for consideration, at its regular meetings on those dates, the proposed written contracts (Exhibits D and F, [126] respectively, to the Second Amended and Supplemental Complaint), proposed to be entered into with the plaintiff, and unanimously voted to authorize and direct the Chairman of the Board to execute said specific contracts with plaintiff. Each of these contracts contained a covenant that the person signing on behalf of the County was 'fully authorized and empowered to sign, execute and deliver the same and that all legal requirements have been fully complied with'."

7. Paragraph 7 is true.

"8. The facts alleged in Paragraph XI, Subparagraph 1 of the Second Amended and

Supplemental Complaint are true in all respects.

“9. The facts alleged in Paragraph XI, Subparagraph 2, of said Complaint are true in all respects.

“10. The facts alleged in Paragraph XI, Subparagraph 3, of said Complaint, are true in all respects.

“11. The facts alleged in Paragraph XI, Subparagraph 4, of said Complaint, are true in all respects.

“12. The facts alleged in Paragraph XI, Subparagraph 5, of said Complaint, are true in all respects.

“13. The facts alleged in Paragraph XI, Subparagraph 6, of said Complaint, are true in all respects.

“14. The facts alleged in Paragraph XI, Subparagraph 7, of said Complaint, are true in all respects.”

8. Paragraphs 8 through 14 are true, except, as alleged in this Defendants' answer to the Second Amended and Supplemental Complaint, Paragraph 8, there were not eight separate work orders or projects, and except the legal conclusions in said Paragraphs 8 through 14 of [127] the “Requests for Admissions” are untrue.

/s/ WILLIS H. WARNER.

Subscribed and Sworn to Before Me this 11th day of December, 1957.

[Seal]      /s/ VELDA LOCKETT,

Notary Public in and for Said  
County and State.

My Commission Expires March 28, 1960.

Certificate of service attached.

[Endorsed]: Filed December 12, 1957. [128]

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[Title of District Court and Cause.]

STATEMENT OF GENUINE ISSUES  
IN REPLY FOR SUMMARY JUDGMENT

Defendants set forth herein a statement of the genuine issues in reply to Plaintiff's Motion for Summary Judgment:

1. Whether or not there was one repair job;
2. Whether or not that repair job was estimated to cost \$6500.00;
3. Whether or not there was an adoption of plans and specifications and advertising for bids in conformity with the Government Code of the State of California, Section 25450 and following.

Dated: December 18, 1957.

JOEL E. OGLE,  
County Counsel;

STEPHEN K. TAMURA,  
Assistant;

ADRIAN KUYPER,  
Deputy.

By /s/ ADRIAN KUYPER,  
Attorneys for Defendants.

Certificate of service by mail attached.

[Endorsed]: Filed December 20, 1957. [130]

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[Title of District Court and Cause.]

### DECISION

The various motions of plaintiff and defendants heretofore argued and submitted are now decided as follows:

1. The motion of the plaintiff filed November 26, 1957, for judgment on the pleadings in favor of the plaintiff, pursuant to Rule 12(c), Federal Rules of Civil Procedure, is denied.

2. The motion of the plaintiff filed December 11, 1957, for summary judgment in favor of the plaintiff, pursuant to Rule 56, Federal Rules of Civil Procedure, is denied.

3. The motion of the defendants filed November 6, 1957, for judgment on the pleadings in favor of the defendants and for the dismissal of the sec-

ond amended and supplemental [132] complaint filed October 18, 1957, is granted, with costs to the defendants.

Formal judgment to be prepared by counsel for the defendants.

### Comment

It appears on the face of the pleadings that the contract on which suit is attempted to be brought violates the provisions of Sections 25450, 25451 and 25452 of the California Government Code. Recovery cannot be had upon any theory of implied contract, estoppel or on a quantum meruit, or against the Chairman of the Board of Supervisors personally. (Miller v. McKinnon, 1942, 20 C.2d 83; County of San Diego v. California Water and Telephone Company, 1947, 30 C.2d 817.)

Even assuming that the present provision of Section 25450.5 allows, by implication, the splitting of contracts in counties having less than 900,000 population, the fact is that in this case there was no such splitting. The plaintiff cannot by treating the various types of work as separate contracts, avoid the consequences of the provisions of the California statute which makes the letting of such a contract, without advertisement and without specifications void.

The final contract entered into dated November 7, 1956, called for the work as a whole to be completed at the price of \$7,511.60. The plaintiffs,



themselves, treated the contract as a whole. The mechanics lien executed by them on February 4, 1957, and recorded in the records of Orange County of February 7, 1957, recited:

“Said Lien is claimed for labor and material for cleaning, painting and repairing the elevated water tank aforesaid, done and furnished at the request of Orange County Board of Supervisors, Orange County Purchasing Agent, and Board of Hospital Commissioners, for and used in the work of improvement of said tank between the second day of October, 1956, and the 21st day of November, 1956. That the amount due claimant and unpaid on account of said contract, after deducting all just credits and offsets, is the sum of \$7,511.60, with interest from November 24, 1956.” (Emphasis added.)

The Minutes of the Board of Supervisors under which the contract was executed recited:

“A regular meeting of the Board of Supervisors of Orange County, California, was held November 7, 1956 at 9:30 a.m. The following named members being present: Willis H. Warner, Chairman; C. M. Featherly, Ralph J. McFadden, Wm. H. Hirstein, Heinz Kaiser and the Clerk.

“In Re: Contact for Emergency Repairs—Repair  
High Water Tank Oange County Hospital  
—Dixie Tank and Bridge Company

“On motion of Supervisor Kaiser, duly seconded and unanimously carried, the Chairman was au-

thorized to sign the contract with Dixie Tank and Bridge Company for the repair of the High Water Tank at the Orange County Hospital, in the amount of \$7,511.60." (Emphasis added.)

We realize that the application of these principles in the instant case results in the injustice of having a company which has furnished labor and materials to a county deprived of the value of such labor and materials. Were we free to follow our own ideas of fairness we would adopt the rule enunciated in *Gamewell Co. v. City of Phoenix*, 1954, 216 F.2d 928, 940-941. But this being a diversity case [134] we are bound to follow California law and policy which prohibits recovery under any theory. (See, *Angel v. Bullington*, 1947, 330 U.S. 183, 191; *Sutton v. Leib*, 1952, 342 U.S. 402, 406; *Woods v. Interstate Realty Co.*, 1949, 337 U. S. 535, 538.) In such cases a federal court is "in effect only another court of the state." (*Guaranty Co. v. York*, 1945, 328 U.S. 99, 108.)

Hence the ruling above made.

Dated this 24th day of December, 1957.

/s/ LEON R. YANKWICH,  
Judge.

[Endorsed]: Filed December 24, 1957. [135]

[Title of District Court and Cause.]

PLAINTIFF'S OBJECTIONS TO DEFEND-  
ANTS' PROPOSED DRAFT OF JUDG-  
MENT

Plaintiff, Dixie Tank & Bridge Co., objects to the form of the judgment proposed by the defendants, that is, to the inclusion therein of any new findings, especially the two new proposed findings that the Second Amended and Supplemental Complaint fails to state a claim on which relief can be granted, and that there is no genuine issue as to any material fact.

These two findings should be eliminated from the judgment, because (1) such findings in a judgment are improper; because (2) no such findings are contained in the Court's decision; and because (3) these findings are incompatible with the Court's decision.

The decision, on its face, resolves the evidence on the issue of one contract *vel non* in favor of the defendants; and affirmatively takes into account, as evidence on that issue, a matter which (a) was outside the Second Amended and Supplemental Complaint and the Answer thereto, and (b) was [136] neither presented to nor urged upon the Court by either party as bearing on the motion or motions. This outside matter is the claim of mechanic's lien alluded to as evidence of one contract in the Court's decision.

This reference to the claim of mechanic's lien indicates that the Court resolved the issue of one contract vel non on the merits, and, of course, without a trial.

The defendants' motion for judgment on the pleadings under F.R.C.P. Rule 12(c) was not and could not be based on the alleged failure of the Second Amended and Supplemental Complaint to state a claim on which relief could be granted, because a motion based on that ground must be made before the defendant's answer is filed under F.R.C.P. Rule 12(b); and also because it is provided in both F.R.C.P. Rule 12(b) and 12(c) that if, on a motion under either "matters outside the pleadings are presented to and not excluded by the Court, the motion shall be treated as one for summary judgment and be disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56." This was not done with respect to the claim of mechanic's lien.

The sole ground for summary judgment under F.R.C.P. Rule 56 is that "the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact, and that the moving party is entitled to a judgment as a matter of law." Both these conditions must coincide to justify a summary judgment.

Here, the defendants not only did not move for a summary judgment. Instead, they filed a statement

of genuine issues of fact in opposition to plaintiff's motion for summary judgment and to plaintiff's proposed findings of fact and conclusions of law, all of which documents were filed pursuant to Local Rule 3(d)(2); and in this statement, they (the defendants) pointed out the existence of three genuine issues of fact in this case, including the issue of whether or not there was one repair job only, hence one contract *vel non*. It was this "genuine issue" that the Court resolved in the defendants' favor without a trial, by taking into account as evidentiary matter, the claim of mechanic's lien which was outside the present pleadings and not presented to [137] the Court by either party for consideration on the motion.

The three genuine issues of fact pointed out by the defendants were, whether there has been an adoption of plans and newspaper advertising for bids, whether there was one repair job only, and whether this was estimated to cost \$6,500.00. Plaintiff, under the pleadings, deemed these issues genuine, but moved for summary judgment on the ground that they were immaterial as legitimate defenses for either of the defendants, for reasons set forth in the Second Amended and Supplemental Complaint.

The Court decided that at least one of these genuine issues was material as a defense, and then proceeded to decide the issue as though upon a trial; whereas, only a motion for judgment on the pleadings was before the Court on behalf of the defend-



ants. The mere fact that plaintiff was deemed not entitled to a summary judgment did not entitle the defendants to judgment on the pleadings.

Surely, no new findings of fact such as those proposed by the defendants should be inserted in the judgment, as they would be out of place, and incompatible with the Court's decision, which did not include and was not based on any such findings.

Respectfully,

/s/ JAMES C. R. McCALL,  
Attorney for Plaintiff.

[Endorsed]: Filed December 31, 1957. [138]

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In the United States District Court Southern  
District of California, Central Division

No. 597-57—Y

DIXIE TANK & BRIDGE CO., a Corporation,  
Plaintiff,

vs.

COUNTY OF ORANGE, a County of the State of  
California; and WILLIS H. WARNER,

Defendants.

### JUDGMENT

The motion of the Plaintiff, filed November 26, 1957, for judgment on the pleadings in favor of

the Plaintiff, and the motion of the Defendants, filed November 6, 1957, for judgment on the pleadings in favor of the defendants and for dismissal of the Complaint, came on regularly for hearing on December 16, 1957, and the motion of the Plaintiff, filed December 11, 1957, for summary judgment in favor of the Plaintiff, came on regularly for hearing on December 23, 1957, both in Department 7 of the above-entitled Court, before the Honorable Leon R. Yankwich, Judge Presiding; James C. McCall, appearing for Plaintiff, and Joel E. Ogle, County Counsel, and Adrian Kuyper, Deputy County Counsel, by Adrian Kuyper, appearing for Defendants; the matters were argued by Counsel, and submitted for decision; the Court being fully advised, [140] and having considered the pleadings on file herein and the exhibits on file and attached thereto.

Now, Therefore, it appearing to the Court on the face of the pleadings:

That the contract on which suit is attempted to be brought violates the provisions of Sections 25450, 25451 and 25452 of the California Government Code. Recovery cannot be had upon any theory of implied contract, estoppel or on a quantum meruit, or against the Chairman of the Board of Supervisors personally. (Miller v. McKinnon, 1942, 20 C. 2d 83; County of San Diego v. California Water and Telephone Company, 1947, 30 C. 2d 817.)

That even assuming that the present provision of Section 25450.5 of the California Government

Code allows, by implication, the splitting of contracts in counties having less than 900,000 population, the fact is that in this case there was no such splitting. The plaintiff cannot by treating the various types of work and the purchase orders for them as separate contracts, avoid the consequences of the provisions of the California statute which makes the letting of such a contract, without advertisement and without specifications, void.

The final contract entered into dated November 7, 1956, called for the work as a whole to be completed at the price of \$7,511.60.

It Is Ordered for the reasons above stated and pursuant to Rule 12(c) of the Federal Rules of Civil Procedure that judgment be entered in favor of the Defendants and against the Plaintiff. That Plaintiff take nothing against the Defendants or either or any of them by said Complaint and that the Complaint be and the same is hereby dismissed with costs to the defendants.

Dated: December 31, 1957.

/s/ LEON R. YANKWICH,  
Judge.

[Endorsed]: Filed December 31, 1957.

Entered January 2, 1958. [141]

[Title of District Court and Cause.]

## NOTICE OF APPEAL

Notice Is Hereby Given that Dixie Tank & Bridge Co., the plaintiff above named, hereby appeals to the United States Court of Appeal for the Ninth Circuit from the final judgment filed herein on December 31, 1957, and entered in this action on January 2, 1958.

Dated: January 27, 1958.

/s/ JAMES C. R. McCALL,  
Attorney for Appellant.

Affidavit of Service by Mail attached.

[Endorsed]: Filed January 27, 1958. [142]

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[Title of District Court and Cause.]

## APPELLANT'S STATEMENT OF POINTS ON APPEAL

On the appeal in this action, Appellant Dixie Tank & Bridge Co. intends to rely on the following points:

1. The Court erred in granting defendants' motion for judgment on the pleadings.
2. The Court erred in overruling and failing to grant plaintiff's motion for judgment on the pleadings in its favor.

3. The Court erred in overruling and failing to grant plaintiff's motion for summary judgment against the defendants. [144]

\* \* \*

Dated: January 27, 1958.

/s/ JAMES C. R. McCALL,  
Attorney for Appellant.

[Endorsed]: Filed January 27, 1958. [146]

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[Title of District Court and Cause.]

#### CERTIFICATE BY THE CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 150, inclusive, containing the original:

Complaint, filed 5/7/57.

Amended and Supplemental Complaint, filed 7/22/57.

Answer to Amended and Supplemental Complaint.

Motion and Notice of Motion for Judgment on the Pleadings and for Dismissal, etc., filed 7/30/57.



Affidavit in Support of Motion for Judgment on the Pleadings and for Dismissal.

Minute Order of 9/18/57.

Second Amended and Supplemental Complaint, filed 10/18/57.

Answer to Second Amended and Supplemental Complaint.

Motion and Notice of Motion for Judgment on the Pleadings and for Dismissal, etc., filed 11/6/57.

Plaintiff's Memorandum on Motions for Judgment.

Notice and Motion for Judgment on the Pleadings in Favor of Plaintiff.

Affidavit of W. A. Riley (on Motions for Judgment).

Notice and Motion for Summary Judgment in Favor of Plaintiff.

Proposed Findings of Fact and Conclusions of Law.

Proposed Summary Judgment.

Responses to Requests for Admissions.

Statement of Genuine Issues in Reply for Summary Judgment.

Decision.

Plaintiff's Objections to Defendants' Proposed Draft of Judgment.

Judgment.

Notice of Appeal.

Appellant's Statement of Points and Designation of Record on Appeal.

Appellee's Designation of Portions of the  
Record on Appeal not designated by Appellant.

I further certify that my fee for preparing the  
foregoing record, amounting to \$1.60, has been paid  
by appellant.

Dated: February 7, 1958.

[Seal]                      JOHN A. CHILDRESS,  
Clerk;

By /s/ WM. A. WHITE,  
Deputy Clerk.

---

[Endorsed]: No. 15886. United States Court of  
Appeals for the Ninth Circuit. Dixie Tank & Bridge  
Co., a Corporation, Appellant, vs. County of Orange,  
a County of the State of California, and Willis H.  
Warner, Appellees. Transcript of Record. Appeal  
From the United States District Court for the  
Southern District of California, Central Division.

Filed: February 10, 1958.

Docketed: February 12, 1958.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for  
the Ninth Circuit.

No. 15886

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

JOEIE TANK & BRIDGE Co., a Corporation,

*Appellant,*

*vs.*

COUNTY OF ORANGE, a County of the State of California,  
and WILLIE H. WARNER,

*Appellees.*

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BRIEF FOR APPELLANT.

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JAMES C. R. McCALL,

3325 Wilshire Boulevard, Suite 1012,  
Los Angeles 5, California,

*Attorney for Appellant.*

FILED

SEP - 8 1958

PAUL F. O'BRIEN, CLERK



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No. 15886

IN THE

**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

DIXIE TANK & BRIDGE Co., a Corporation,

*Appellant,*

*vs.*

COUNTY OF ORANGE, a County of the State of California,  
and WILLIS H. WARNER,

*Appellees.*

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**BRIEF OF APPELLANT.**

---

**Jurisdictional Statement.**

Federal jurisdiction below and on appeal is based on 28 U. S. Code, Sections 1332(a)(1) and 1291, respectively.

Dixie Tank & Bridge Co., plaintiff below, sued the County of Orange and Willis H. Warner, defendants below, for \$7,511.60, due on contracts express or implied, in the U. S. District Court for the Southern District of California. That Court entered final judgment against plaintiff on January 2, 1958, dismissing, upon defendants' motion for judgment on the pleadings, the plaintiff's Second Amended and Supplemental Complaint, without leave to amend; and overruled plaintiff's two motions, (1)

for summary judgment and (2) for judgment on the pleadings. From the judgment Dixie Tank & Bridge Co. appeals. [R. 58-74, 164-167.]

The action is between citizens of different states, appellant being a Tennessee corporation and the appellees being a California county and an individual resident thereof. The matter in controversy exceeds \$3,000.00. [R. 58-59, 74, 92.] Appellant contends the District Court's actions on all three motions were erroneous. [R. 165-168.]

### Statement of the Case.

Between October 2 and November 21, 1956, Dixie Tank & Bridge Co. ("Dixie" herein), a contractor, furnished the necessary labor and materials and duly performed, to the full satisfaction of the County of Orange, eight separate work projects, each for an agreed separate price. The projects were let to Dixie in three contracts entered into pursuant to competitive bidding. Two of the contracts were signed by the County's Board of Supervisors (called "the Board" herein), and the third by the County's Purchasing Agent acting by express authority of the Board. [R. 59-61, 65-90, 92, 151-154.]

The combined effect of the eight work projects, the agreed price of no single one of which amounted to \$4,000.00, was to completely clean, scale, repair, repaint, and replace or adjust accessory parts on, the County's 100,000-gallon elevated steel water tank at the County General Hospital near Orange, California, for a total of \$7,511.60.

It is agreed in the pleadings that the labor and materials furnished by Dixie in performing the work were of the reasonable worth and value of \$7,511.60, that the reasonable worth and value of such labor and material furnished



for each part of the work equals the agreed price therefor, and that the County has accepted, is using, and intends to keep the product of such work and material without paying Dixie anything whatever therefor. [R. 65, 93, Par. IX and Answer thereto.]

The Board rejected in full Dixie's four verified claims for the work on May 28, 1957. [R. 61, 92, Par. VI and Answer thereto.] Under Government Code, Section 25203, the Board has control of the County's defense in this action.

The Board's defense, asserted in the County's Answer [R. 62-63, 92-93, Par. VII and Answer thereto], is an affirmative defense, to wit, that the Board itself was guilty of statutory misfeasance in allegedly failing to "adopt plans, specifications, strain sheets and working details" for the tank repair work, and in allegedly failing to "cause an advertisement for bids for the performance of the work to be published in a . . . newspaper" before letting the work to Dixie, which adoption and advertisement the Board now claims were necessary to meet requirements for a valid contract under Government Code, Sections 25450, 25451 and 25452.

The two contracts which the Board signed with Dixie covered all eight projects. The Board, acting through its Chairman, appellee Willis H. Warner, who was a member of the Board, signed these contracts after the Board had expressly approved the language thereof by unanimous resolution authorizing the Chairman to sign such contracts on its behalf. Each contract contained a covenant that:

"The party (Mr. Warner) or parties (the Board) signing this contract on behalf of the First Party (the County) covenant and agree that they are fully au-

thorized and empowered to sign, execute and deliver the same, and *that all legal requirements have been fully complied with.*" [R. 64, 68-69, 70-71, 82-83, 88-89, 152-154.] (Explanatory parenthesis inserted.)

Dixie relied on these covenants of legality in performing the contracts, as appears from the affidavit of its president, W. A. Riley. [R. 132.]

In addition to its two contracts with the Board dated October 2 and November 7, 1956, respectively [R. 80-82, 84-89], Dixie was employed to perform the same work for the same prices, *i.e.*, for Dixie's bid prices for the eight projects [R. 77-78], by Purchase Order No. 62659 issued by the Purchasing Agent October 5, 1956, which Purchase Order was amended by Change Order issued by the Purchasing Agent on November 13, 1956. [R. 83-84, 89-90.] The Board's authorizations for all these documents, including the Purchase and Change Orders, appear in the Second Amended and Supplemental Complaint and the appellees' Answer thereto and their admissions made on request. [R. 65-70, Par. X-XI, 93, 151-156.]

The total repair work was naturally and necessarily divided or separated by County officials, and by the Board, into eight work projects, for reasons of economy, and because the extent and kind of welding of seams, rivets and pits that would be required to repair the tank was unknown and could not be ascertained or determined before the tank had been rigged, cleaned, scaled and inspected. [R. 63, 129-130.] The work was not split by the Board for the purpose of evading the competitive bidding statute, but was split in good faith for the above reasons. [R. 63-64, 153-154, Par. VIII (1) and admission 6.]

Because the amount of welding was unknown and unascertainable pending the cleaning, scaling and inspection, Dixie bid unit prices for the three welding items, *i.e.*, 60 cents each for welding all rusted out rivets, and pits in tank plates, and \$3.50 per lineal foot for welding deteriorated seams. Dixie bid flat sums for each of the other five projects. [R. 75-78.] The work done pursuant to this bid and ensuing contracts, therefore, was as follows:

The tank was cleaned and scaled for \$550.00; 3,616 of rusted out rivets were then welded (at 60 cents each) for \$2,169.70; 712 lineal feet of deteriorated seams were welded (at \$3.50 per foot) for \$2,492.00; all loose sway rods were tightened and adjusted for \$150.00; the tank interior was primed and relined for \$650.00; the tank exterior and tower were cleaned, primed and repainted for \$650.00; and catwalk plates were replaced, as needed, for \$850.00. These seven items, or projects, total the \$7,511.60 total price aforesaid. No pits needed welding, so, nothing was due for the other, or eighth project, *i.e.*, to "weld all pits in tank plates that are over halfway through tank plates" at 60 cents each. [R. 60, 66-71, 77-90.]

These eight projects were let to Dixie by the Purchasing Agent and the Board at the separate prices aforesaid as the result of, and pursuant to, actual, bonafide competitive bidding conducted by mailed Requests for Bid circulated by the Purchasing Agent to five qualified bidders, including Dixie, with the approval of the Board. The Board not only adopted the recommendation of its hospital committee that the work be so split and "arranged for" by the Purchasing Agent, but after such splitting and advertising by mail, the Board itself entered into the

two contracts aforesaid with Dixie, paralleling the orders issued by the Purchasing Agent. [R. 63-65, 66-71, 75-90, 92-94, 128-134, 151-155.]

That is, the Board both authorized and ratified all acts of the Purchasing Agent in dealing with the Dixie.

The first of the Board's contracts obligated Dixie to clean, scale, and paint the inside and outside of the tank for \$1850.00, which is the exact total of the figures \$550.00, \$650.00, and \$650.00 at which Dixie had bid to perform the same three projects in its response to the Purchasing Agent's Request for bids. [R. 77-78, 81-82.] In this contract of October 2, 1956, the Board and Dixie agreed that after the cleaning and scaling of the inside of the tank had been done, so as to enable the County and Dixie to determine, by inspection, what rivets and seams needed welding, flat prices would then be reached for the welding before it was done. [R. 82.]

After the cleaning, scaling, and inspection, the County determined that 3,616 rusted out rivets needed welding, which at 60 cents each would amount to \$2169.60, and that 712 lineal feet of deteriorated seams needed welding, which at the agreed \$3.50 per foot, would amount to \$2492.00; and on November 7, 1956, the second and final contract for the work was executed by the Board, including these new items which could not be determined beforehand, and fixing the full cost of all the prospects at \$7511.60. [R. 84-88.]

This total was \$1011.60 more than the \$6,500 the Board had previously authorized the Purchasing Agent to spend; but the Board by resolution added that amount, and the Purchasing Agent issued a Change Order to Dixie to cover. [R. 89-90.]

Dixie thereupon completed all the work and the same was inspected, approved and accepted by the County on November 21, 1956. [R. 90.]

On November 24, 1956, Dixie billed the County for its work as follows [R. 91]:

Per Purchase Order No. 62659, Dated October 5, 1956. Scaling, Cleaning and Painting Interior and Exterior, Labor and Material .....	\$1,850.00
Welding of 712 feet seams @ 3.50 per lineal foot .....	2,492.00
Welding of 3616 Rivets @ .60 per rivet .....	2,169.60
Tighten and adjust all loose Sway Rods .....	150.00
Replace catwalk plates where necessary .....	850.00
Total .....	<hr/> \$7,511.60

The Board then first advanced the claim that it had acted unlawfully to Dixie's loss. After several months of negotiations with County Counsel and the Board, Dixie on May 18, 1957 filed and presented to the Board its four verified claims for its work and materials on the eight projects; and these the Board rejected on May 28, 1957. [R. 61-62, 92.] Dixie filed suit.

Orange County, California, contains less than 500,000 population. In 1956 its population was 216,224. [R. 151].

### Contentions of the Parties.

A claim that there was "only one job" for \$7,511.60 and that the Board was guilty of misfeasance in its duties is the County's only defense in this case. [R. 92-94.]

Dixie contends that it engaged in actual, bonafide competitive bidding for eight work projects, and won the faithfully performed all three contracts therefor, and is



justly entitled to payment of the actual and agreed value of its work and materials, whether or not the Board failed to "adopt working details" or to "advertise in a newspaper" (which Dixie does not admit), because:

1. The work was split or divided by the Board into eight work projects, separately priced, each under \$4,000.00, and such splitting was not prohibited, but was impliedly authorized by Government Code, Sections 25351, 25450.5 and 25464; and the contracts for the split work are lawful, since Orange County's population in 1956 was under 500,000, and was in fact 216,224.

2. The County is estopped by the Board's covenants to claim or prove the Board's self-claimed derelictions of duty.

3. The eight work projects were adopted by the Board through Requisition M2946 A and the Purchasing Agent's Request for Bid, and are legally sufficient "working details"; and the Board's asserted failure to make full newspaper advertising for bids, even if proved, would show at most a mere "irregularity or invalidity in the exercise of a general power to contract"; hence the County is "responsible on implied contract for the payment of benefits it receives under an illegal express contract not prohibited by law."

4. And, if the County should escape liability because all legal requirements had not been fully complied with by the Board, Mr. Warner as member of the Board and as signer of the covenants, is liable to Dixie on the covenants.

Dixie also contends that the District Court, regardless of the law otherwise applicable in the case, improperly sustained the defendants' motion for judgment on the pleadings, because there was a genuine issue on the

face of the pleadings as to whether the Board had or had not adopted plans and/or advertised for bids in a newspaper. [R. 156.] Dixie further contends that it was entitled, on its own motions, to summary judgment against the County and/or Mr. Warner under the pleadings and admissions of record.

### Judgment Below.

In deciding the motions, the District Court said [R. 165-166]:

“Now, Therefore, it appearing to the Court on the face of the pleadings:

“That the contract on which suit is attempted to be brought violates the provisions of Sections 25450, 25451 and 25452 of the California Government Code. Recovery cannot be had upon any theory of implied contract, estoppel or on a quantum meruit, or against the Chairman of the Board of Supervisors personally. (Miller v. McKinnon, 1942, 20 C. 2d 83; County of San Diego v. California Water and Telephone Company, 1947, 30 C. 2d 817.)

“That even assuming that the present provision of Section 25450.5 of the California Government Code allows, by implication, the splitting of contracts in counties having less than 900,000 population, the fact is that in this case there was no such splitting. The plaintiff cannot by treating the various types of work and the purchase orders for them as separate contracts, avoid the consequences of the provisions of the California statute which makes the letting of such a contract, without advertisement and without specifications, void.

“The final contract entered into dated November 7, 1956, called for the work as a whole to be completed at the price of \$7,511.60.

“It Is Ordered for the reasons above stated and pursuant to Rule 12(c) of the Federal Rules of Civil Procedure that judgment be entered in favor of the Defendants and against the Plaintiff. That plaintiff take nothing against the Defendants or either or any of them by said Complaint and that the Complaint be and the same is hereby dismissed with costs to the defendants.”

### **Assignments of Error.**

1. The Court erred in granting defendants' motion for judgment on the pleadings.
2. The Court erred in overruling and failing to grant plaintiff's motion for judgment on the pleadings in its favor.
3. The Court erred in overruling and failing to grant plaintiff's motion for summary judgment against the defendants.

### **Statutes and Rules Involved.**

1. Civil Code of California, Sections 1641, 1642, 1643, 1644, 1649, and 1650.
2. Government Code of California, Sections 23004(c), 23005, 25021, 25351, and 25450 to 25466, inclusive. [See Sections copied in R. 117-124.]
3. Former Political Code of California, Section 4041.18, repealed in 1947. [See R. 113-116 and Distribution Table into Government Code, R. 126-127.]
4. Federal Rules of Civil Procedure, Rules 12(c), 41(b), 52(a), 56(c), and 75(e).
5. Local Rules, U. S. District Court, Southern District of California, Rules 3(d)(2) and 4(d).

The Civil Code sections cited above provide, in substance, that a contract is to be construed as a whole and so as to give effect to every part; that several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction are to be taken together and “receive such an interpretation as will make it lawful, operative, definite, reasonable and capable of being carried into effect, if it can be done without violating the intention of the parties”; that words are to be understood in their ordinary and popular sense and interpreted in the sense in which the promisor believed that the promisee understood them; and that particular clauses are subordinate to the general intent of the contract. (Secs. 1641-1644, 1649, 1650.)

In 1956, the pertinent provisions of the Government Code sections cited above [see R. 117-124], were as follows:

Sections 23004(c), 23005, 25021:

“‘A county may \* \* \* make contracts’; and ‘may exercise its powers only through the board of supervisors or through agents and officers acting under the authority of the board’; and ‘the chairman of the board shall perform such duties as are prescribed by law or by the board.’”

Section 25351:

“The board may \* \* \* repair buildings for a hospital.”

Sections 25450-25466 (Construction, Alteration and Repair of Buildings) as follows:

“Whenever the estimated cost of construction \* \* \* or the cost of any repairs (to any hospital or other public building) exceeds the sum of four

thousands dollars (\$4,000) \* \* \* the work shall be done by contract. Any such contract not let pursuant to this article is void.” (Sec. 25450.)

“In any county containing a population of *500,000 or over*, it is unlawful to split or separate into smaller work orders or projects any public work project for the purpose of evading the provisions of this article requiring public work to be done by contract after competitive bidding.” (Sec. 25450.5.)

“The board \* \* \* shall adopt plans, specifications, strain sheets and working details for the work.” (Sec. 25451.) “The board shall cause advertisement for bids for \* \* \* the work to be published \* \* \* in a \* \* \* newspaper.” (Sec. 25452.) “All bidders shall be afforded opportunity to examine the plans, specifications, strain sheets and working details.” (Sec. 25453.) “The board shall award the contract to the lowest responsible bidder.” (Sec. 25454.)

“In counties employing a purchasing agent, \* \* \* materials and supplies used in the \* \* \* repair of any works mentioned in Sec. 25450 costing not more than two thousand dollars (\$2,000) may be purchased by the purchasing agent \* \* \* without the formality of obtaining bids, letting contracts, preparing specifications and other things required by this article for purchases costing more than two thousand dollars (\$2,000).” (Sec. 25457.) (By Stats. 1957 ch. 1719, Sec. 1, this Sec. 25457 was amended to authorize “employment of independent contractors used in” the repair of such works, by the purchasing agent.)

“The method of payment for construction contracts shall be determined by the board \* \* \*.” (Sec. 25464.)



Former Political Code, Section 4041.18 [R. 113-116] provided, in pertinent part as follows:

“Under such limitations and restrictions as are prescribed by law \* \* \* the board \* \* \* shall have the *jurisdiction and power* to \* \* \* repair hospital \* \* \* and other public buildings. \* \* \* Wherever \* \* \* the cost of any repairs (to any hospital or other public buildings) shall exceed the sum of five hundred dollars, such work shall be done by contract, and any contract therefor shall be void unless the same shall be let as hereinafter provided.”

Section 4041.18 also directed the adoption of plans and newspaper advertising for bids, and authorized purchases by purchasing agents up to \$2,000, in substantially the same terms as were used in 1956 Government Code, Sections 25451, 25452, 25453 and 25454.

Federal Rules of Civil Procedure, Rule 12(c), authorizes judgment on the *pleadings only*, excluding “matters outside the pleadings.” Rules 41(b), 52(a), and 56(c), govern motions for summary judgment, and authorize such a judgment on “the pleadings \* \* \* and admissions on file, together with the affidavits, if any,” where there is no genuine issue as to any material fact, but they appear to require the Court to make findings of fact when, on such a motion, judgment is rendered against the plaintiff.

Federal Rules of Civil Procedure, Rule 75(e), requires abbreviation of the record on appeal by eliminating all but one copy of any document and by abridging and omitting irrelevant portions of all document, and excluding “all matter not essential to the decision of the decision of the questions presented by the appeal”; and

provides sanctions to discourage excessive designations of non-essential matter.

Local Rule 4(d) requires that an amended pleading “must be retyped and filed so that it will be complete in itself, including exhibits, without reference to the superseded pleading.”

Local Rule 3(d)(2) requires a party to serve and file with his motion for summary judgment, “proposed findings of fact and conclusions of law and proposed summary judgment,” which appellant did in this case. [R. 135-151.]

### Statement as to the Record.

The printed Transcript of Record is replete with unusual contents. Surprisingly, upon designation by the appellees, it contains [R. 99-127] a brief filed by appellant below, which brief includes, as Appendices A, B and D thereto, copies of all pertinent parts of former Political Code, Section 4041.18 and of Government Code, Sections 25351, and 25450 through 25466, inclusive (cited above), and a Table of Distribution tracing the transition of clauses from one code to the other. Also, but not so fortunately, upon designation by the appellees, the Transcript of Record contains [R. 3-66] all the pleadings and motions filed before Dixie’s Second Amended and Supplemental Complaint. This complaint, pursuant to Local Rule 4(d), was complete in itself, including exhibits, and it superseded all prior pleadings, motions, etc.

These designations by appellees were excessive, and violated the record abbreviation provisions of Federal Rules of Civil Procedure, Rule 75(e), in that the result is an inflated, punitive record, full of confusing and use-

less duplications of superseded documents and arguments of counsel, *i.e.*, full of matter which is neither essential nor pertinent to the decision of any question on this appeal. Specifically, pages 3 through 54 and pages 99 through 127 (total, 81 pages) of the 170 page printed transcript, contain nothing but useless matter. This is the exclusive fault of the appellees, as a comparison of the designations of the record by the parties below and here will clearly show. These designations are in the clerk's office. Only pages 56 through 95 and pages 127 through 170 (total 82 pages) are pertinent in any way to the decision on this appeal.

Sanctions ought to be applied to the appellees on account of these excessive designations.

However, this excessive matter does contain copies of of the statutes above cited; and Dixie asks to be relieved of the burden and added cost of reproducing these statutes again in an appendix to this brief.

The proposed findings of fact and proposed judgment [R. 136-151, total 15 pages] were necessarily filed below under Local Rule 3(d)(2) as a part of, and with, Dixie's motion for summary judgment [R. 135-136], and are therefore a part of the moving papers which show the District Court's error in not granting plaintiff's motion for summary judgment.

## ARGUMENT.

### SUMMARY.

The District Court wholly misconstrued, and erroneously voided, the Final Contract dated November 7, 1956. By its express terms, this was a "merged" or consolidated, final contract; and is to be taken and read with the Board's prior contract of October 2, 1956, the Purchasing Agent's purchase order of October 5, 1956, and the requisition and bid on which it was based. These documents, and the facts pleaded and admitted, prove beyond all doubt that the work was intentionally split and let by the County in eight separate projects, each for a separate agreed price; and that the various projects were united in the final contract for the sole purpose of establishing by agreement the total sum due for all the various projects separately priced and performed by Dixie.

The splitting was entirely lawful under Government Code, Sections 25351, 25450.5 and 25464, since Orange County did not have a population exceeding 500,000, and none of the split projects exceeded \$4000.00.

The splitting being lawful, the mere fact that the eight projects were let in three contracts, later merged into one to establish an agreed total, rather than in eight separate contracts, is immaterial, and does not render the splitting illegal or nugatory.

The District Court's view that the work could not be split by "treating the various types of work and the purchase orders for them" as separate projects for separate prices is error. The language of the statute (Govt. Code, Sec. 25450.5) contemplates that the Board may "split or separate into smaller work orders or projects

any public work project.” What more logical method for splitting “into smaller work orders or projects” could there be than by dividing the work by “the various types of work” at separate prices?

Actually, the District Court imposed here a “no splitting” rule of its own, in the face of the authority for splitting inherent in the statute under the rule *expressio unius est exclusio alterius*.

The District Court erroneously voided the express covenants of full legal compliance, made by the Board and Mr. Warner, whose duties it was to adopt plans, etc. and advertise in a newspaper, if that were necessary. The County is estopped by this covenant; or else, Mr. Warner is, and ought to be, liable personally thereon. The court’s view unprecedentedly expands the derivative immunity of public officials from liability for their own misfeasance, to include immunity even where they have covenanted personally that they have already properly performed acts subsequently shown, or claimed, to have been omitted by them.

The face of the pleadings did not justify judgment for defendants thereon; but did justify judgment thereon for plaintiff under the doctrines of estoppel and implied contract. (Fed. Rules Civ. Proc., Rule 12(c).) And, certainly, under Federal Rules of Civil Procedure, Rule 56(c), plaintiff was entitled to summary judgment against one or the other of the defendants on the undisputed facts.



I.

The Contracts Are Valid.

1. In the absence of some *specific* charter or statutory provision, municipal contracts need not be let under competitive bidding.

*Davis v. City of Santa Ana*, 108 Cal. App. 2d 669, 239 P. 2d 656 (1952);

*Swanton v. Corby*, 38 Cal. App. 2d 227, 100 P. 2d 1077 (1940).

2. There is no *specific* provision in the present county public works act which forbids a county containing *less than 500,000 population* to split a public work into smaller work orders or projects, and avoid the requirements of competitive bidding. The only prohibition on this subject is that in *Government Code*, Section 25450.5, against evasive splitting in the larger counties. In view of this expressly limited prohibition, under the rule of *expressio unius est exclusio alterius*, such splitting is permitted in the smaller counties.

23 Cal. Jur. 741, Sec. 118, n. 20;

*Smith v. Eureka Flour Mills Co.*, 6 Cal. 1, 7 (1856).

Indeed, the *Government Code* now gives county boards of supervisors general, *plenary* power to make contracts for the repair of hospital and other public buildings, and to determine the method of payment therefor, unrestricted to any particular mode of contracting. This includes discretion to split a public work into smaller work orders or projects, as conferred by the express, limited, prohibition.

*Govt. Code*, Secs. 23004(c), 25351, 25450.5, 25464.

3. It is true that on the ground of "public policy," the court in *Miller v. McKinnon*, 20 Cal. 2d 83, 124 P. 2d 34, 140 A. L. R. 570 (1942), inferred a ban on all splitting under the former act. (Pol. Code, Sec. 4051.18, which act was itself wholly silent on the subject of splitting.) However, the legislature has now expressly determined the limits of the prohibition against splitting, and thereby has fixed the state's public policy on the subject, in *Government Code*, Section 2450.5. No judicial extension of the prohibition is warranted.

50 *Am. Jur.* 214-216, Sec. 229.

4. Where a statute enumerates things upon which it is to operate, it is to be construed as excluding from its effect all those not expressly mentioned.

*Shelby v. Southern Pacific Co.*, 68 Cal. App. 2d 594, 157 P. 2d 442, 445 (1945).

5. Primarily, it is for the legislature to determine the public policy of the state, not the courts.

*Building Service Employees Int. Union, Local 262 v. Gazzam*, 339 U. S. 532, 536, 70 S. Ct. 784, 787, 94 L. Ed. 1045 (1949);

*Safeway Stores v. Retail Clerks Int. Ass'n*, 41 Cal. 2d 567, 261 P. 2d 721 (1953).

The paramount public policy is that freedom to contract is not to be interfered with lightly. It is the court's duty to sustain the legality of a contract, in whole or in part, if it can do so.

*Garcelon's Estate*, 104 Cal. 570, 38 Pac. 414, 43 A. S. R. 134, 32 L. R. A. 574 (1894);

*Andrews v. Horton*, 8 Cal. App. 2d 40, 47 P. 2d 496 (1935);

12 *Am. Jur.* 670-671, Sec. 172.

6. As no specific provision of law, and hence no public policy, was violated by the letting by Orange County of eight split work projects, each for a separate price under \$4,000.00 (whether with or without plans or newspaper advertising), the tank work contracts were valid. This is certainly true as to the contracts of October 2 and 5, 1956 [Exs. D and E to complaint] which, with welding expressly excluded as provided in Exhibit D, Section 2 [R. 82], covered only \$2,850.00 of work. The argument as to invalidity is pertinent *only* to the Final Contract, that of November 7, 1956, which included the welding projects.

7. The Final Contract “merges” into itself the prior contracts [R. 85], and as so merged, supersedes the others; hence all the contracts, and explanatory documents, are to be “taken together” as a whole, and interpreted so as to make the whole agreement legal and operative, rather than unlawful and void, and in the sense Dixie understood and the parties intended, subordinating particular clauses to the general intent and giving effect to every part of the whole agreement.

*Civ. Code*, Secs. 1641, 1642, 1643, 1644, 1649, and 1650;

12 *Cal. Jur.* 2d 333-334, Sec. 123.

So taken and interpreted, all the contracts are valid.

8. The intention of the parties is to be sought and given effect, in any contract. If the Final Contract were void, it cannot be assumed that, by the “merger” clause, the parties intended to render invalid the prior valid contracts totaling \$2,850.00. In any event, Dixie would be entitled to that.

9. The county itself is liable for interest from November 24, 1956, under the amended statute covering interest.

*Civ. Code*, Sec. 3287.

## II.

### The County Is Estopped to Claim the Law Was Violated.

1. The Orange County Board of Supervisors had the power and discretion to determine the method of payment, and to split and let the tank work, with or without statutory competitive bidding. It had the legal power and the duty to adopt plans and working details and to advertise for bids, if it should decide to *let the work without splitting*: and it had the power to reject all bids, and do the work by day's work, if the bids submitted were too high. Finally, and in any event, it had the legal power and duty to determine for itself whether it had met all its precedent legal duties, and, based on its determination thereof, to let the contract, or contracts, for the work. Also, it has control of the County's defense in the case.

*Govt. Code*, Sections:

1st sentence: 25464, 25450, 25450.5;

2nd sentence: 25451, 25452, 25456;

3rd sentence: 23004(c), 23005, 25351;

4th sentence: 25021.

2. Because of its broad powers to determine and act in these matters, and because it would be extremely difficult or impossible for an outsider to ascertain the facts, or the purposes, of the Board with certainty by inquiry, the county is estopped by the affirmative representation by the Board that all legal requirements had been fully complied.

*Gunnison County v. E. H. Rollins & Sons*, 173

U. S. 255, 19 S. Ct. 390, 43 L. Ed. 689 (1899).

3. The covenants of full legal compliance, made by the Board Chairman in executing the contracts of October 2, 1956 and November 7, 1956, were representations of the Board, because the Board had expressly authorized the chairman to sign, on its behalf, these specific contracts containing these specific warranties. [R. 154.]

*Eyer (Geo. H.) & Co. v. Mercer County*, 292 Fed. 292 (D. C. Ky. 1923) aff'd 1 F. 2d 609.

4. The county is therefore estopped to claim the contracts are void for the Board's alleged misfeasance in failing to advertise for bids in a newspaper or to adopt working details.

*Gunnison County v. E. H. Rollins & Sons*, *supra*.

### III.

#### The County Is Liable on Implied Contract.

1. Under the rule in *Miller v. McKinnon*, 20 Cal. 2d 83, 124 P. 2d 34, 140 A. L. R. 570, a county is liable on implied contract for the value of benefits received under an illegal express contract where—

(a) The Board of supervisors is given general power to contract with reference to the subject matter of the express contract;

(b) The manner of entering into the express contract, although irregular, was not violative of specific statutory restriction on the general power, nor of public policy.



As shown above, all these conditions are met, in view of the new provisions of the Government Code which did not appear in the Political Code.

*Govt. Code*, Secs. 25351, 25450, 25450.5, 25464, and 23004(c);

*Pol. Code*, Sec. 4041.18 [R. 113-116];

*Gamewell Co. v. City of Phoenix*, 216 F. 2d 928 (C. A. 9, 1954).

2. Deficient advertising for bids is a mere irregularity permitting recover for the value of benefits received.

*McCormick Lumber Co. v. Highland School District*, 26 Cal. App. 641, 147 Pac. 1183 (1915).

(This opinion was distinguished, not overruled, in *Miller v. McKinnon*, and is now a precedent of full vigor.)

3. Plans and working details, which cannot be determined in advance, or would be of no practical value, are not required. (The eight separate work items listed in Requisition M 2946A [R. 75-78], were sufficient as plans and working details for the letting in this case.)

*City Street Improvement Co. v. Kroh*, 158 Cal. 308, 110 Pac. 933 (1910);

35 Cal. Jur. 2d 271, Sec. 478.

4. Since bids from five qualified persons were solicited, and there was *bona fide* competitive bidding, the alleged irregularities in this case were not so grave as to bar relief on implied contract; and, indeed, in view of the broad new discretionary powers of the Board, there has never been a reported case in California under which a plaintiff would be denied relief against a county on the facts of this case.

IV.

**Defendant Warner Is Alternatively Liable for Breach of Covenant.**

1. An agent who expressly warrants the capacity of his principal to enter into a contract is liable for breach thereof. (Here an express covenant is pleaded.)

*Restatement of Agency*, Sec. 332, Comment C;

2 *Am. Jur.* 250, Sec. 318, n. 6;

*Bear River Sand & Gravel Co. v. Placer County*,  
118 Cal. App. 2d 684, 258 P. 2d 543.

V.

**Judgment for Defendants Was Premature, Under F.R.C.P. Rule 12(c); Plaintiff's Motions for Judgment Should Have Been Granted.**

1. Judgment on the pleadings for plaintiff was unauthorized, because the Court had to, and did consider matters outside the pleadings—to wit, whether plans had been adopted and newspaper advertisement made.

*F.R.C.P.* Rule 12(c);

*Chappell v. Johnson Lumber Co.*, 216 F. 2d 873  
(C. A. 9, 1954).

2. Upon estoppel from the pleaded facts, plaintiff was entitled to judgment in its favor on the pleadings; and since there is no genuine issue as to any material fact as to which defendants are not estopped, plaintiff was entitled to summary judgment against one or the other defendant.

*F.R.C.P.* Rules 12(c) and 56(c).

**Conclusion.**

The judgment should be set aside and judgment rendered here, or ordered rendered blow, in favor of plaintiff for \$7,511.60 plus interest from November 24, 1956 against one or the other appellee.

Respectfully submitted,

JAMES C. R. McCALL,

*Attorney for Appellant.*



## APPENDIX.

### Admission of Exhibits, Etc.

Appellant's motion for judgment on the pleadings was based on the Second Amended and Supplemental Complaint and Exhibits A to I thereto attached, and the appellee's Answer thereto and their admissions of record in response to appellant's requests, as appears from the notice of motion; and these were considered by the Court on said motion. [R. 127-128, 58-91, 92-94, 151-156.]

Appellant's motion for summary judgment was based on all the above documents, together with the affidavit of W. A. Riley, and appellant's proposed findings of fact and conclusions of law and proposed summary judgment, as appears from the notice of motion; and all these, with the appellee's Statement of Genuine Issues (filed in opposition), were considered by the Court on said motion. [R. 135-136, 137-140, 150-151, 156-157 and 128-135.]





No. 15886.

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

DIXIE TANK & BRIDGE Co., a corporation,

*Appellant,*

*vs.*

COUNTY OF ORANGE, a County of the State of California,  
and WILLIS H. WARNER,

*Appellees.*

---

## BRIEF FOR APPELLEES.

---

JOEL E. OGLE,

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FILED

OCT 7 1958

PAUL P. O'BRIEN, CLERK



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---

**BRIEF FOR APPELLEES.**

---

**1. Statement of the Case.**

The events upon which the Second Amended Complaint was attempted to be founded arose out of work done by the plaintiff-appellant on a high-water tank located on the grounds of the Orange County General Hospital in the fall of 1956. As shown by the Minute Order of the Board of Supervisors of the County of Orange, dated August 28, 1956 [part of Ex. "E," R. 31], the original estimate of the job was \$6,500.00. There is no allegation that this estimate was ever less than this amount. The estimated cost was increased on November 7, 1956, by the amount of \$1,011.60 [R. 32] making a total bill of \$7,511.60, which is the amount finally billed and the amount prayed for in the Second Amended Complaint [R. 45].

No advertising for bids ever took place regarding this job nor was there any adoption of plans or specifications or strain sheets. None is alleged in the Complaint [R. 58-74] or in the affidavit of Mr. Riley, president of appellant [R. 128-134]. Such action is denied by the answer [R. 92-93] and by the uncontradicted affidavit of Mrs. Graham, Assistant Purchasing Agent of appellee [R. 55-56].

Both plaintiff-appellant and defendants-appellees moved for judgment on the pleadings in the trial court, and judgment thereon in favor of defendants was made and entered [R. 164-166].

Plaintiff-appellant appeals.

## 2. Argument.

The Government Code of the State of California, by its Section 25450 provides,

“whenever the *estimated* cost of any construction of any . . . public building or the cost of any repairs thereto exceeds the sum of \$4,000.00 . . . the work shall be done by contract. Any such contract not let pursuant to this article is *void*.” (Emphasis added.)

The article referred to requires advertising for bids and adoption of plans and specifications (Secs. 25452, 25451); neither advertising for bids nor adoption of plans or specifications occurred in connection with this job.

The California cases construing this act are quite clear that not only is the contract void, but no recovery *in quantum meruit* is allowed.

*Miller v. McKinnon*, 20 C.2d 83, 124 P.2d 34, was a taxpayer's action to recover over 42,000.00 expended by Santa Clara County on repairing a rock quarry. The trial

court dismissed the action after sustaining a demurrer to the complaint on the ground that no action was stated. The Supreme Court reversed with directions to overrule the demurrer. The Court stated such contracts as are let without competitive bidding cannot be ratified, that no estoppel to deny their validity can be invoked against the County for entering into contracts without such bidding, that no recovery in quasi contract can be had pursuant to such contracts. The Court also pointed out that persons dealing with any public agency are presumed to know the law with respect to the requirement of competitive bidding and act at their peril. Extensive citations of authority to support these general propositions are found on page 88 of 20 C.2d and page 37 of 124 P.2d. The Court, in addition, stated that the job cannot be split into separate parts as a device for thwarting the public policy declared in the Government Code.

*County of San Diego v. California Water and Telephone Company*, 30 C.2d 817, 186 P.2d 124, was an action by a County against a utility company to enjoin the completion of a dam on which the company had already spent \$800,000.00, because the work was causing a flooding of a county highway. The utility company alleged the county had abandoned the highway in question and had accepted an easement from the company for another location. The easement contained an agreement that the company would not be liable for flooding damage to the highway. The Court held the agreement was *ultra vires* and void. There was no estoppel. The Court stated that neither the doctrine of estoppel nor any other equitable principle may be invoked against a governmental body where it would operate to defeat the effective operation to protect the public.

These two cases have been cited with approval by the Supreme Court of this State as recently as 1956 in *City of Oakland v. Burns*, 46 C.2d 401, at page 405; 296 P.2d 333, at page 336, and by the appellate courts of this State as recently as February of 1958 in *Paterson v. Board of Trustees*, 157 C.A.2d 811, at pages 819, 820, and 821; 321 P.2d 825, at pages 829 and 830.

Nor can Mr. Warner, the Chairman of the Board of Supervisors acting as agent for the County, in signing the various contracts alleged in the Complaint, be held liable:

“When an officer or public agent contracts in good faith with parties having knowledge of the extent of his authority or who have equal means of knowledge, *especially where the authority of the officer is prescribed by law*, he will not become individually responsible unless the intent to incur liability is clearly expressed, although it should be found that, through ignorance of the law, he may have exceeded his authority.” (4 McQuillin, Municipal Corporations 163, Sec. 12.214.) (Emphasis added.)

*Hancock v. Burns*, 158 A.C.A. 882, 888, 323 P.2d 456, 460;

*Martelli v. Pollock*, 162 A.C.A. 701, 705, 328 P.2d 795, 797.

Mr. Warner's signature, furthermore, is not even as a County official alone: it is merely a clerical act evidencing the determination of the Board. A member of the Board of Supervisors is not liable in damages for his official acts, except as prescribed by statute.

*Dawson v. Martin*, 150 C.A.2d 379, 382, 309 P.2d 915, 917.

### 3. Appellees' Disagreements With Appellant's "Statement of the Case."

Appellees agree generally with the "Statement of the Case" appearing in appellant's brief, pages 2 through 7, except for the descriptive terms used and legal conclusions drawn. A proper Statement of the Case should begin with the fact that the first event which occurred in connection with the work which is the subject of this case is the minute order of the Board of Supervisors of the appellee County dated August 28, 1956, which stated that the estimated cost of the work to be performed was \$6,500.00 [Ex. E, R. 31]. Appellee, in its brief, describes this work as "eight separate work projects" (App. Br. p. 2) into which the total repair work was allegedly divided by the County officials (App. Br. p. 4). These "work projects" is a reference to the items listed on the requisition sent out by the County [App. Br. p. 5; R. 75, 77, 78, 83 and 84]. Thus, when appellant speaks in its brief in the "Statement of the Case" of "work projects," it is referring to the items which make up the total repair work.

Appellees disagree with the allegation in appellant's "Statement of the Case," at page 3 of its brief, that the Board's defense is that "the Board itself is guilty of statutory misfeasance." The fact more accurately stated is that there was a failure to adopt plans, specifications, strain sheets and work details and a failure to cause an advertisement for bids to be published, both as required by Sections 25450, 25451 and 25452 of the Government Code.

Appellees disagree with the statement that the repair work was "naturally and necessarily divided or separated by County officials" (App. Br. p. 4) and the reasons



therefor. The fact is there was no division or separation, but only an itemization of what constituted the total repair work. The reasons alleged are a conclusion of the appellant.

Appellees disagree with the statement of appellants that there was "competitive bidding" (App. Br. pp. 2, 5), as the uncontradicted affidavit of the Purchasing Agent, used to support appellee's motion on the judgment for pleadings, demonstrates, there was a mailing of some four or five forms for the receipt of bids, but "there was no advertising for bids for the performance of the work . . . and no plans, specifications, strain sheets, and working details for the work adopted by the Board of Supervisors . . . ." [R. 55.]

#### 4. Appellant's Citations Are Not in Point.

##### 1. Page 18 of its brief:

*Davis v. City of Santa Ana*, 108 C.A.2d 669, 239 P.2d 656, and *Swarton v. Corby*, 38 C.A.2d 227, 100 P.2d 1077, were concerned with whether particular contracts were "public projects" or "public work," and decided the contracts before them—garbage collection and short wave radio installation, respectively—were *not*. In the instant case, we are concerned with a contract obviously within the governing statute—"the estimated cost of construction of any *public building* or the cost of any *repairs* thereto . . . ." Government Code, Section 25450. Appellant has never contended this case is not based on a public work.

##### 2. Page 19 of its brief:

*Shelby v. Southern Pacific Co.*, 68 C.A.2d 594, 157 P.2d 442, 445, deals with a tort case, whether stopping a railroad crossing is enumerated in the Code.

Both *Garcelon's Estate*, 104 C. 570, 38 P. 414, and *Andrews v. Horton*, 8 C.A.2d 40, 47 P.2d 496, dealt with contracts in which the Court decided the public had no interest.

3. Pages 21 and 22 of its brief:

*Gunnison County v. E. H. Rollins & Sons*, 173 U.S. 255, 19 S.Ct. 390, 43 L.Ed. 689, a Colorado case, held that a bona fide holder of bonds which recited compliance with the state law that a certain amount of indebtedness could not be exceeded, but which was exceeded, could still collect. The reasoning of the Court was that the law gave the power to the County commissioners to determine whether the debt had been exceeded and therefore the bona fide holder could not determine that for himself, but had to rely on the statement in the bond.

*Eyer Co. v. Mercer County*, 292 Fed. 292, 1 F.2d 609, a Kentucky case, held that, as in the *Gunnison County* case, a County which promised a certain indebtedness was not exceeded, when it alone knew the facts, was estopped from denying the fact the indebtedness was exceeded as against a holder of a note.

These cases are to be distinguished from the case at bar where the appellant knew as well as the County that no plans or specifications or strain sheets had been adopted, and knew as well as the County that no newspaper advertisement for bids had taken place. The test set forth in the *Eyer* case itself is, at page 294, whether the individual dealing with the government, can have a "ready ascertainment of the truth in regard to the matter covered by the recital."

*Miller v. McKinnon*, 20 C.2d 83, 124 P.2d 34, has been briefed *supra* and does *not* stand for the proposition set

out on page 22 of appellant's brief. The Supreme Court of this State expressly stated in that decision, at page 88 of 20 C.2d and page 37 of 124 P.2d, that there would *not* be recovery on implied contract. Such recovery would be a transparent violation of the Government Code prohibition which renders the contract *void*.

4. Page 23 of its brief:

*Gamewell Co. v. City of Phoenix*, 216 F.2d 928 (C.A. 9, 1954), did *not* allow the contract therein to be enforced against the defendant. There was, it is true, a denial of the right of the defendant to recover payments from the plaintiff, and the trial judge here, who wrote the Court of Appeals decision there, said frankly in his judgment here that "were we free to follow our own ideas" that recovery would be allowed [R. 16], but, of course, "this being a diversity case, we are bound to follow California law and policy which prohibits recovery under any theory." [R. 160.]

*McCormick Lumber Co. v. Highland School District*, 26 C.A. 641, 147 P. 1183, was decided upon facts showing "irregularities occurring in the matter of the notices calling the meeting of the electors and asking for the submission of bids," but not, as here, a total failure of advertising. The Supreme Court, in the *Miller* case, at page 90, of 20 C.2d, and pages 38-39 of 124 P.2d, said that the *McCormick* case "involved a situation where *there was a compliance with the statutory requirements* but they were merely insufficient." (Emphasis added.) As the Court there went on, describing the *Miller* situation, but which language is appropriate to the case at bar: "Under the complaint here involved no advertisement for bids was made in proper form, defective form, or any form."

*City Street Improvement Co. v. Kroh*, 158 C. 308, 110 P. 933, does *not* hold that plans or “working details” are dispensable altogether, but only that a report of a highway commission need not go into detail and that some “slight or reasonable departure therefrom in the final specifications” (page 315 of 158 C., and page 937 of 110 P.) was not fatal to a contract subsequently let.

5. Page 24 of its brief:

*Bear River Sand & Gravel Co. v. Placer County*, 118 C.A.2d 684, 258 P.2d 543, holding *against* recovery by the plaintiff-contractor, points out, at page 689 of 118 C.A.2d, and page 546 of 258 P.2d: “The road commissioner [defendant] was without power to negotiate such a sale [purchase of crushed rock], and *so was the board of supervisors without advertising for bids.*” The Court then cites a number of cases, including *Miller v. McKinnon*, and proceeds, still at pages 689 and 546, respectively: “When the power of a board or public officer is limited to a prescribed method of contracting, the mode prescribed becomes the measure of the power. If the prescribed mode is disregarded, the contract is void and unenforceable.” The Court held that the road commissioner was *not* an agent of the County, his acts could *not* be ratified by the Board of Supervisors, and the Court discussed the question of public officials as agents, at pages 690 and 546, respectively:—the words are appropriate here regarding Mr. Warner—

“One who deals with a public officer stands charged presumptively with a full knowledge of that officer’s powers and is bound at his peril to ascertain the extent of his power to bind the government of which he is an officer, and any act of an officer to be valid must find express authority in the law or be neces-

sarily incidental to a power expressly granted . . . No government, whether state or local, is bound to any extent by an officer acting in excess of his authority even though it has received substantial benefits deriving from the *ultra vires* act. . . . Since [the] road commissioner was not authorized by any provision of the law to purchase materials of any character for use on the county roads, the county of Placer could not be bound.”

The sustaining of the demurrer to the count of the complaint against the commissioner himself, “framed upon the theory that the road commissioner warranted himself to be an agent of the county” (pp. 684 and 544, respectively), was likewise affirmed on the appeal.

### 5. Statement Regarding the Record.

Appellant has stated that the printing of its earlier pleadings—the first two complaints and attendant papers—was unnecessary (App. Br. pp. 14-15), although appellant adopts portions of the “excessive designations” in its own brief (at pp. 15 and 27).

Our answer to this charge is as follows:

The appellant’s brief is lengthy, confusing, and contradictory in theory, and it is therefore difficult to answer the various contentions. The appellant’s method of procedure in the District Court was likewise lengthy, confusing, and contradictory and, therefore, in order to preserve the record for whatever theory appellant might adopt on appeal, these appellees-defendants were constrained to request the printing in the record of the various complaints made in the District Court. For example, it is confusing to know whether appellant seriously contends that there were various agreements which were entirely separate



from each other or whether there were three agreements each embodying elements of the other: in its first complaint at Paragraph IV appellant alleged "three agreements" [R. 4] and in the second complaint appellant pleaded "three separate agreements" [R. 37] by which the defendant agreed to pay the plaintiff "separately" in various "projects or orders respectively." [R. 37.]

As another example, appellant has deliberately shifted the emphasis from the original estimate of \$6,500.00. In its first complaint, Paragraph IV(5), appellant mentioned the original \$6,500.00 "estimate, pursuant to the aforesaid authorizations from the Board of Supervisors dated August 28, 1956, and November 7, 1956" [R. 7], and attached as an exhibit to the first complaint the Minute Order of the Board of Supervisors of that August 28, 1956, meeting which specifically stated that the *estimated* cost of the repair of the tank was \$6,500.00. [Ex. E; R. 31.] Appellant deliberately omitted this from the first and second amended complaints and has attempted to gloss over this fact in its brief with only one oblique reference, at page 6 of the brief, where it is pointed out that the final sum of \$7,511.60 was over the \$6,500.00 authorization.

Again, in its first complaint appellant had as part of its argument that the County required itemization of the amounts [Par. VIII; R. 9], which is an obvious reference to defendants' suggestion that the plaintiff bill the County under the emergency repair provision of the Government Code, Section 25458, which allows payment without competitive bidding but which necessitates itemization of costs to plaintiff of materials, supplies and labor. This paragraph was omitted in later versions of appellant's story.

It was in the first amended complaint wherein appellant first argued that there was "actual competitive bidding on

invitations for bids" [R. 44], an allegation omitted from the first complaint, yet this new allegation appears in the same paragraph with appellant's position that the "various work projects involved in said contracts were not required to be so advertised." [R. 44.] The first complaint prayed for attorneys' fees [R. 11] and whether plaintiff must itemize costs [R. 11], was omitted from the later versions. [R. 45, 47.]

Thus it is this welter of confusion on the part of the appellant which compelled the defendants to request that all versions of appellant's story in the District Court be available for reference for this Honorable Court. The confusion is contained in appellant's opening brief: there is confusion as to whether there was one job or a series of projects of separate contracts; there is confusion as to whether there was actual competitive bidding or not and there is confusion as to how much was involved in the contract or series of contracts.

The majority of appellant's authorities are immaterial: its argument concerning splitting of public works in smaller counties of less than 500,000 population is in the first place wrong, because it is allowing a fictitious splitting in order to avoid the express prohibitions of the preceding sections, which never could have been intended by the Legislature, and in the second place is irrelevant to this case since there was no splitting here. As the trial court stated in this case, "the Plaintiffs themselves treated the contract as a whole. The mechanics lien executed by them on February 4, 1957, and recorded in the records of Orange County of February 7, 1957, recited: ' . . . that the amount due claimant and unpaid *on account of said contract . . .*' ". (Emphasis in the Court's opinion.) [R. 158-159.]

## 6. Conclusion.

We believe the facts themselves are clear and that defendants' position has been clear from the commencement of this action. It is simply that the Government Code renders *void* any contract let in violation of its provisions if the *estimated cost* of the job is in excess of \$4,000.00. There was no adoption of plans and specifications and there was no advertising for bids. The plaintiff-appellant can talk on and on about various work "projects", various contracts, various representations, various minute orders of the Board, various invitations to bid, various "competitive bids," various figures in the various contracts. But the appellant can never change the facts that:

1. The job was estimated to be over \$4,000.00, to-wit: \$6,500.00;
2. There was no advertising for bids in a newspaper, nor any adoption of plans and specifications;
3. The Government Code therefore renders the contract void.

## Prayer.

Appellees County of Orange and Willis H. Warner, Chairman of its Board of Supervisors, respectfully pray that the judgment be affirmed.

Respectfully submitted,

JOEL E. OGLE,  
*County Counsel,*

STEPHEN K. TAMURA,  
*Assistant County Counsel,*

and

ADRIAN KUYPER,  
*Assistant County Counsel,*  
*Attorneys for Appellees.*



No. 15888 ✓

**United States**  
**Court of Appeals**  
**For the Ninth Circuit**

*See: Vol. 3062*

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COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

FRANK W. BABCOCK,  
Respondent.

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**Transcript of Record**

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**Petition to Review a Decision of the Tax Court  
of the United States**

**FILED**

MAR 31 1958

PAUL P. O'BRIEN, CLERK





No. 15888

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**United States  
Court of Appeals  
For the Ninth Circuit**

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COMMISSIONER OF INTERNAL REVENUE,  
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

HON. CHARLES K. RICE,  
Asst. U.S. Attorney General;

JOHN N. STULL,  
Acting Asst. Attorney General,  
Tax Division, Dept. of Justice,  
Washington 25, D. C.,

For the Petitioner.

AUSTIN CLAPP,  
1780 Portola Road,  
Woodside, California,

For the Respondent.



The Tax Court of the United States

Docket No. 55993

FRANK W. BABCOCK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1955

Jan. 18—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 20—Copy of petition served on General Counsel.

Jan. 18—Request for Circuit hearing in Los Angeles, Calif., filed by taxpayer. 1/26/55—Granted.

Mar. 11—Answer filed by General Counsel.

Mar. 16—Copy of answer served on Taxpayer—Los Angeles, Calif.

1956

Oct. 19—Hearing set Jan. 7, 1957—Los Angeles, Calif.

Dec. 13—Entry of appearance of Austin Clapp, as counsel, filed.

1957

Jan. 9—Trial had before Judge Atkins, case submitted, Stipulation of Facts, (2 sets), Exhibits 1-A thru 6-F, filed at hearing. Briefs due 3/11/57; Replies due 4/10/57.

1957

Jan. 24—Transcript of Hearing 1/10/57 filed.

Mar. 11—Brief filed by Respondent.

Mar. 12—Motion for extention of time to April 1, 1957, to file brief, and to May 1, 1957, to file reply brief, filed by petitioner. 3/12/57—Granted. Served 3/15/57.

Apr. 3—Brief filed by petitioner. Served 4/3/57.

May 1—Reply Brief filed by petitioner. Served 5/2/57.

June 28—Opinion rendered—Judge Atkins—Decision will be entered under Rule 50. Served 6/30/57.

Aug. 5—Computation filed by petitioner. Served Aug. 6, 1957.

Aug. 6—Hearing set Sept. 11, 1957, Rule 50. Served Aug. 6, 1957.

Aug. 23—Respondent's computation filed. Served 8/27/57.

Aug. 26—Hearing set Sept. 11, 1957, under Rule 50. Served 8/27/57.

Sept. 4—Decision entered—Judge Atkins—Div. 7. Served 9/5/57.

Sept. 6—Agreement to Respondent's computation filed by Petitioner.

Nov. 25—Petition for review by U. S. Court of Appeals, Ninth Circuit, filed by Respondent.

Nov. 25—Statement of Points filed by Respondent.

Dec. 10—Notice of filing petition for review and statement of points with proof of service thereon filed.

1957

Dec. 24—Motion to extend time to and including 2/23/58 for filing record on review and docketing the petition for review filed. Served 12/27/57.

Dec. 26—Order, extending time for filing the record on review and docketing petition for review in the U.S.C.A., 9th Circuit, to 2/23/58, entered. Served 12/27/57.

1958

Jan. 29—Designation of contents of record on review with proof of service thereon filed.

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[Title of Tax Court and Cause.]

## OPINION

Filed June 28, 1957.

Section 112(f), Internal Revenue Code of 1939—Involuntary Conversion—The property of the petitioner was condemned by the State of California under its power of eminent domain. Part of the award was paid by the state to the holder of a purchase money mortgage upon which the petitioner was not personally liable. The remainder was paid to the petitioner who forthwith invested the amount received by him in similar property. Held that failure of the petitioner to invest in similar property the portion of the money which was paid to the mortgagee does not justify recognition of gain to



the petitioner. *Fortee Properties, Inc.*, 19 T.C. 99, followed.

Tax on Real Estate—Assessment Prior to Acquisition by Petitioner—Real estate taxes assessed in March, and which became a lien at that time, held not deductible by petitioner who later in the year acquired title to the property and paid the taxes. *Magruder v. Supplee*, 316 U.S. 394.

AUSTIN CLAPP, ESQ.,

For the Petitioner.

J. EARL GARDNER, ESQ.,

For the Respondent.

### Opinion

Atkins, Judge:

The respondent determined a deficiency in the petitioner's income tax for the calendar year 1949 in the amount of \$15,323.09 and an addition thereto under section 293(a) of the Internal Revenue Code of 1939 in the amount of \$992.38. The petitioner challenges only so much of the deficiency and addition as arises out of the respondent's determination that the petitioner realized a recognizable gain as the result of condemnation of real estate, and that the petitioner is not entitled to a deduction for an amount paid as real estate taxes.

The facts have been stipulated in full and are found as stipulated. A summary of the facts will suffice for the purpose of deciding the issues presented.

## I. Gain on Condemnation Award

The petitioner timely filed his income tax return for the calendar year 1949 with the collector of internal revenue at Los Angeles, California.

In October, 1945, the petitioner purchased real estate known as the Elk Metropole Hotel in Los Angeles at a total cost of \$89,600. At the time of purchase he executed a promissory note secured by a purchase money trust deed (sometimes referred to herein as "mortgage"), covering the land and building in the amount of \$70,000. Principal and accrued interest on that note aggregating \$57,572.63 remained unpaid on November 9, 1949. Interest paid by the petitioner on the note from October 1, 1945, to November 9, 1949, was claimed and allowed as a deduction from gross income in income tax returns filed during that period.

On November 9, 1949, the State of California, under condemnation proceedings, acquired the Elk Metropole Hotel, pursuant to a formal contract entered into between the petitioner and the State of California, which fixed the selling price at \$207,323.34. On or about the same date, and in accordance with the contract,<sup>1</sup> the State of California

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<sup>1</sup>The contract between the petitioner and the State provided that the State should pay the petitioner, as grantor, \$207,323.34 for the property, payment to be made within 90 days after the date title vested in the State free and clear of all liens and encumbrances. However, it was further provided that, upon demand, any or all of the moneys up to

paid to the mortgagee of the property the sum of \$57,572.63 representing the balance due on the trust deed note, and also paid directly to the petitioner the sum of \$149,750.71, which payments aggregated the contract price of \$207,323.34.

In March, 1950, an informal application to establish a replacement fund was made by the petitioner to the respondent. While this was pending, on July 7, 1950, the petitioner purchased the Sherwood Apartment Hotel in Los Angeles as a replacement of the Elk Metropole Hotel. The purchase price of the replacement property was \$186,125 of which \$149,750.71 was paid in cash by the petitioner from the moneys received from the State of California for the Elk Metropole Hotel property.

In his income tax returns for the years 1945 to 1949, inclusive, the petitioner claimed depreciation deductions in respect of the Elk Metropole Hotel in the aggregate amount of \$8,166.66, of which the respondent allowed the amount of \$8,000.

In his notice of deficiency the respondent held that since only \$186,125 was expended by the petitioner for similar property, whereas the amount of

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and including the total amount of the unpaid principal and interest on the note secured by the deed of trust, together with any penalty for payment in full in advance of maturity, should be made payable to the beneficiary under the deed of trust, and that such beneficiary should furnish the grantor (the petitioner) with good and sufficient receipts showing such money credited against the indebtedness secured by the deed of trust.

the condemnation award was \$207,323.34, gain is recognizable to the extent of the difference of \$21,198.34. He treated this as long-term gain and increased the reported taxable income by one-half that amount, or \$10,599.17.

The substance of the petitioner's argument against the recognition of any gain arising out of the condemnation award is that his interest in the property and the interest of the mortgagee were several interests, that he sold only his interest, and that the amount he realized for his interest was fully reinvested in similar property; hence under section 112(f) of the 1939 Code there was no recognizable gain. The computation that he purposes on brief is as follows:

Down payment .....	\$ 19,600.00
Payments on principal.....	12,427.37
<hr/>	
Cost of interest sold.....	\$ 32,027.37
Capital returned via depreciation.....	8,000.00
<hr/>	
Basis of interest sold.....	\$ 24,027.37
Gain realized .....	125,723.34
<hr/>	
Total realized .....	\$149,750.71
Reinvested .....	\$149,750.71
<hr/>	
Gain recognized .....	

Section 112(f) as it existed in 1949 provided as follows:

Involuntary Conversions—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

Section 29.112(f)-1 of Regulations 111 provides in part as follows:

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property and itself pays the same, the amounts so retained shall not be de-



ducted from the gross award in determining the amount of the net award. \* \* \*

In *Fortee Properties, Inc.*, 19 T.C. 99, certain properties of the taxpayer were taken by the Port of New York Authority by condemnation under the power of eminent domain. Each of the properties was encumbered by mortgages which had been placed thereon prior to the time the taxpayer had acquired them. The taxpayer had not assumed the liability but had acquired the properties subject to the mortgages. The taxpayer and the Port of New York Authority agreed upon the total value of the properties. The Authority paid the amount due on the mortgages directly to the holder and paid the balance to the taxpayer. The taxpayer had no control over the payment or disposition of the amount paid in satisfaction of the mortgages. In that case it was held that the taxpayer, by investing the full amount of money which was paid directly to it, had complied with the provisions of section 112(f) and that it was not necessary to such compliance that it also expend in the acquisition of similar property an amount equal to the amount which was directly paid by the Port of New York Authority to the holder of the mortgages. It was pointed out that the taxpayer had not borrowed the money secured by the mortgages, did not receive directly, indirectly or constructively the amount necessary to satisfy the mortgages, and since it was not personally liable for the mortgage indebtedness, did not benefit by the payment of

such indebtedness. Certain cases were distinguished on the ground that therein money awarded was used by the Government to pay liens placed upon the property during the time it was owned by the taxpayer or to pay a debt for which the taxpayer was personally liable. In that case we stated in part:

\* \* \* If his (the Commissioner's) regulation is intended to cover a case like this one in which the petitioner was not personally liable for the mortgages, then to that extent the regulation is invalid because it frustrates rather than promotes the intention of Congress.

\* \* \*

\* \* \* The rather clear intention of Congress would be defeated rather than carried out if a part of the petitioner's gain were to be recognized because it did not also expend in the acquisition of similar property the \$28,970 which it did not have invested in the condemned property, for the payment of which it was not personally liable, and which it did not receive directly, indirectly, or constructively. \* \* \*

That case was reversed in *Commissioner v. Fortee Properties, Inc.*, (C.A. 2, 1954) 211 F. 2d 915, cert. denied 348 U. S. 826. The Court of Appeals in holding in effect that the taxpayer had not complied with the requirements of section 112(f), took the view that, within the meaning of that section, the property sold was the full property and not merely the owner's rights over and above encumbrances,

and that the payment to the mortgagee, even though liability had not been assumed by the taxpayer, benefitted it. In so holding the Court of Appeals relied heavily upon *Crane v. Commissioner* 331 U.S. 1.

In our consideration of the *Fortee* case we gave thorough consideration to the *Crane* case and held that it had no application since it did not involve section 112(f) of the Code. In the *Crane* case the question presented was how a taxpayer, who acquired depreciable property subject to an unassumed mortgage, held it for a period, and finally sold it, still so encumbered, must compute the taxable gain. We were not concerned with any such question in the *Fortee* case. We were concerned with the question whether the taxpayer had invested in similar property all the money received upon the involuntary conversion of his former property so as to comply with the provisions of section 112(f). We have given careful consideration to the holding of the Court of Appeals for the Second Circuit in the *Fortee* case, but with all due respect to that court we adhere to the position taken by us in that case.

We have not overlooked the following statement contained in H. Rept. No. 798, 82nd Cong., 1st Sess., made in connection with Public Law 251, 82nd Cong., Act of Oct. 31, 1951, 65 Stat. 733, 1951-2 C.B. 353, which amended section 112(f):

\* \* \* A problem also arises under the present law where the taxpayer uses a part of the pro-

ceeds from the converted property to pay off indebtedness on the converted property. In such a case the taxpayer is denied the benefits of section 112(f), that is, the taxpayer must pay a tax on any gain from the converted property up to the amount of the proceeds which are used in liquidation of indebtedness on the converted property, even though he also fully replaces the converted property, since the amount used to pay off the indebtedness cannot be directly traced into the replacement property.

In such a case as the instant case and the Fortee case, where an amount is paid to the mortgagee under a mortgage as to which the taxpayer has no personal liability, we think the money so used should not be considered as money received by the taxpayer. Cf. *Kennebec Box & Lumber Co., Inc., v. Commissioner* (C.A. 1), 168 F. 2d 646, and *Ovider Realty Co. v. Commissioner* (C.A. 4), 193 F. 2d 266, both affirming decisions of this Court.

There is no essential difference between the in-state case and the Fortee case. The petitioner, under the condemnation procedure, entered into an agreement with the State of California fixing the amount of the award at \$207,323.34, and the State of California directly paid off the mortgage indebtedness out of the \$207,323.34. Here, although the mortgage was placed upon the property by the petitioner at the time of purchase, there was no personal liability



upon him for payment thereof, the mortgagee having recourse only against the property, in view of sections 580b and 580d of the California Code of Civil Procedure (West's Annotated California Codes, vol. 16, pp. 57 and 60),<sup>2</sup> as construed in *Stone v. Lobsien*, 112 Cal. App. 2d 750, 247 P. 2d

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2§ 580b. Purchase money mortgages, etc.; no deficiency judgment.

No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to secure payment of the balance of the purchase price of real property.

Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof. \* \* \*

§ 580d. Foreclosure under power of sale; no deficiency judgment; exceptions:

No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property hereafter executed in any case in which the real property has been sold by the mortgagee or trustee under power of sale contained in such mortgage or deed of trust.

The provisions of this section shall not apply to any deed of trust, mortgage or other lien given to secure the payment of bonds or other evidences of indebtedness authorized or permitted to be issued by the Commissioner of Corporations, or which is made by a public utility subject to the provisions of the Public Utilities Act. \* \* \*



357, and Mortgage Guarantee Co. v. Sampsell, 51 Cal. App. 2d 180, 124 P. 2d 353<sup>3</sup>.

We accordingly hold that the respondent erred in treating any part of the condemnation award as a recognizable gain.

## II. Deductibility of Real Estate Taxes

On or about February 14, 1949, the petitioner entered into an escrow agreement for the purchase of certain real property in block 38, Hancock's Survey in the City and County of Los Angeles, California. On the first Monday in March, 1949, taxes were assessed in the name of the record owner, Fridi Seeber, against the property by the authorities of Los Angeles County. The terms of the escrow agreement were satisfied and settlement was made by the parties on April 4, 1949. In December, 1949, the petitioner paid taxes in the

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<sup>3</sup>In *Stone v. Lobsien* it was stated:

\* \* \* This was a purchase money deed of trust, and, in this state, there is no personal liability imposed on the vendee of a purchase money deed of trust. In the event of a default, no deficiency judgment could have been taken against appellant. § 580b, Code Civ. Proc.; \* \* \*

In *Mortgage Guarantee Co. v. Sampsell* it was stated:

\* \* \* Section 580b, which is the section upon which appellant relies in this case, states, in effect, that there can be no deficiency judgment at all where property is sold under a purchase money mortgage or deed of trust. In other words, for a purchase money mortgage or deed of trust the security alone can be looked to for recovery of the debt. \* \* \*

amount of \$862.30 which had been assessed against the property on the first Monday in March, 1949, while in escrow. The petitioner in his income tax return for the calendar year 1949 claimed a deduction for such payment of \$862.30. The respondent disallowed the deduction on the ground that these taxes were imposed upon the seller and that the payment by the petitioner constituted a capital expenditure.

In *Magruder v. Supplee*, 316 U.S. 394, the Supreme Court, in deciding whether a vendee of real property was entitled to deduct state and city real property taxes stated:

\* \* \* A tax lien is an encumbrance upon the land, and payment, subsequent to purchase, to discharge a pre-existing lien is no more the payment of a tax in any proper sense of the word than is a payment to discharge any other encumbrance, for instance a mortgage. \* \* \*

\* \* \*

Thus, either a pre-existing tax lien or personal liability for the taxes on the part of a vendor is sufficient to foreclose a subsequent purchaser, who pays the amount necessary to discharge the tax liability, from deducting such payment as a "tax paid." \* \* \*

That case also establishes that in ascertaining the existence of either a personal liability for the tax on the part of a vendor or the existence of a lien

prior to the time of purchase thereof resort must be had to the law of the taxing authority.

The State of California Revenue and Taxation Code (West's Annotated California Codes, vol. 59, pp. 204, 334 and 341) provides in pertinent parts as follows:

§ 405. Annual assessment; time

Annually, the assessor shall assess all the taxable property in his county, except State assessed property, to the persons owning, claiming, possessing, or controlling it at 12 o'clock meridian of the first Monday in March. The assessor shall ascertain such property between the first Mondays in March and July. \* \* \*

§ 2187. Tax on real estate; lien

Every tax on real property is a lien against the property assessed. \* \* \*

§ 2192. Lien date

All tax liens attach annually as of noon on the first Monday in March preceding the fiscal year for which the taxes are levied. \* \* \*

In view of these provisions of the statute it seems clear that the property taxes in question are those for the state's fiscal year ended June 30, 1950, but that a lien on account thereof attached to the property as of the first Monday in March, 1949. At that time the conditions of the escrow agreement had not been met and title to the property had not passed to the petitioner.

The petitioner first contends that the equitable owner of the property is personally liable for the tax and may be assessed for it, relying upon the case of *First Trust & Savings Bank of Pasadena v. Los Angeles County*, 206 Cal. 240, 273 Pac. 1066. The petitioner has cited no case, nor has any come to our attention, under which it could be considered that the petitioner obtained an equitable title to the property under the escrow agreement. Insofar as we can determine, neither equitable nor legal title passed from the original owner prior to the settlement on April 4, 1949.

The petitioner also contends that he should be considered as claiming and controlling the property on the first Monday in March, 1949, within the meaning of section 405 of the Revenue and Taxation Code quoted above. He has cited us no authority to support this contention and we have been unable to find any. Normally an escrow agreement, as we understand it, does not give the vendee control over the property or a claim to it prior to the satisfaction of the terms of the escrow.

We have held that under the laws of California the liability for property taxes is determined by the ownership of the property on the first Monday in March. *California Sanitary Co., Ltd.*, 32 B.T.A. 122, *Crown Zellerbach Corporation*, 43 B.T.A. 541, *Pacific Southwest Realty Co.*, 45 B.T.A. 426 (affirmed on other issues (C.A. 9), 128 F. 2d 815).

Here we think the petitioner was not, on the first Monday of March, 1949, the person owning,

claiming, possessing or controlling the property within the meaning of the California statute and that hence the taxes were not imposed upon him. Rather, we believe that when he did become the owner of the property it was impressed with a lien and that his discharge of such lien constituted a capital expenditure in the nature of additional cost of the land to him and that he is not entitled to deduct the amount of \$862.30 as taxes paid, under section 23(c) of the Internal Revenue Code of 1939.

The respondent determined an addition to the tax under section 293(a) in the amount of \$992.38. The petitioner does not allege error in the respondent's assertion of the addition, but does question the amount thereof. Section 293(a) provides:

Negligence—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, \* \* \*.

The proper amount of the addition to tax will be fixed pursuant to the computation under Rule 50.

Decision will be entered under Rule 50.

Served: June 30, 1957.

Entered: June 30, 1957.



Tax Court of the United States

Docket No. 55993

FRANK W. BABCOCK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Opinion filed June 28, 1957, the petitioner herein, on August 5, 1957, filed a recomputation for entry of decision, and the respondent herein, on August 23, 1957, filed a recomputation for entry of decision. The above recomputations are in agreement, and therefore, it is

Ordered and Decided: That there is a deficiency in income tax in the amount of \$4,161.77 for the taxable year 1949, and additions to tax under section 293(a), Internal Revenue Code of 1939, in the amount of \$727.40.

Entered: September 4, 1957.

[Seal]     /s/ CRAIG S. ATKINS,  
Judge.

Served: September 5, 1957.

Entered: September 5, 1957.

[Title of Tax Court and Cause.]

### STIPULATION OF FACTS

It is stipulated that the following facts may be received in evidence without further proof; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts stipulated; and provided, further that both parties to this stipulation reserve the right to object to the materiality and relevancy of any of the facts herein stipulated.

1. Petitioner Frank W. Babcock is an unmarried individual with residence at 501 South Los Angeles Street, Los Angeles, California. The petitioner filed his income tax return for the calendar year 1949 with the Collector of Internal Revenue at Los Angeles on March 15, 1950. Copy of the return is attached hereto as Exhibit 1-A.

2. On or about February 14, 1949, petitioner entered into an escrow agreement for the purchase of certain real property in Block 38, Hancock's Survey in the City and County of Los Angeles, State of California, as per map recorded in Book 7, pages 96 and 97, of Miscellaneous Records in the office of the County Recorder of said county and state. Copies of the escrow statement are attached as Exhibits 2-B and 3-C, respectively.

3. On the first Monday in March, 1949, taxes were assessed in the name of Fridi Seeber, the rec-

ord owner of the real property, against the said real property by the appropriate authorities of Los Angeles County, California. The escrow regarding the purchase and sale of the aforementioned property was to close on April 1, 1949, but did not close until April 4, 1949, as shown by the escrow instructions and statement, Exhibits 2-B and 3-C. Taxes were pro rated as of date of close of the escrow. (Exhibits 2-B, 3-C). In December, 1949, petitioner paid \$862.30 of the taxes assessed against the real property on the first Monday in March, 1949, while in escrow. Petitioner claimed a deduction for such payment on his income tax return for the calendar year 1949, which deduction was disallowed by respondent.

4. On or about October 1, 1945, petitioner purchased real property known as the Elk Metropole Hotel located in the City of Los Angeles at a total cost of \$89,600.00.

5. At the time of the purchase the petitioner executed a promissory note secured by a purchase money trust deed covering the land and the building in the sum of \$70,000.00, of which \$57,572.63, representing principal and accrued interest, remained unpaid as of November 9, 1949. Attached as Exhibit 4-D is a copy of the escrow instructions dated August 3, 1945.

6. Petitioner paid interest on the unpaid balance of said promissory note and trust deed from October 1, 1945, to November 9, 1949, which was

reported and allowed as a deduction from gross income in his income tax returns covering this period.

7. On November 9, 1949, the State of California, under condemnation proceedings, acquired said real property pursuant to a formal contract entered into between the petitioner and the State of California dated July 21, 1949, fixing the selling price at \$207,323.34. Also, on or about November 9, 1949, and in accordance with the provisions of the contract dated July 21, 1949, the State of California paid the mortgagee the balance due on the trust deed note of \$57,572.63 and paid directly to the petitioner \$149,750.71 for a total payment of \$207,323.34. Attached as Exhibits 5-E and 6-F, respectively, are copies of the contract to purchase dated July 21, 1949, and the receipt retained by the State of California for the payment of \$149,750.71 to Frank W. Babcock dated November 9, 1949.

8. Between November 9, 1949, and March, 1950, petitioner endeavored to find a suitable replacement property.

9. In early March, 1950, an informal application to establish a replacement fund was made by petitioner to the Commissioner of Internal Revenue, and while this was pending, a suitable replacement was found in the Sherwood Apartment Hotel, 431 South Grand Avenue, Los Angeles, California, which was purchased by petitioner for \$186,125.00, of which \$149,750.71 was paid in cash by the petitioner from the moneys received from the State

of California for the Elk Metropole property. The purchase of the Sherwood Apartment Hotel was made on or about July 7, 1950.

10. Section 580a, Code of Civil Procedure for the State of California provides in part as follows:

“Whenever a money judgment is sought for the balance due on an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, the court may render judgment for not more than the amount by which the entire amount of the indebtedness due at the time of sale exceeded the fair market value of the real property or interest therein sold at the time of sale with interest thereon from the date of the sale; provided, however, that in no event shall the amount of said judgment, exclusive of interest after the date of sale, exceed the difference between the amount for which the property was sold and the entire amount of the indebtedness secured by said deed of trust or mortgage.”

/s/ AUSTIN CLAPP,

Counsel for Petitioner.

/s/ JOHN POTTS BARNES, R.E.M.

Chief Counsel, Internal Revenue Service, Counsel  
for Respondent.



## EXHIBIT 4-D

## Escrow Instructions

Los Angeles, California

Escrow No. 2227-822-jj/jr

August 3, 1945

## Title Insurance and Trust Company:

On or before Sept. 30, 1945, I will hand you the sum of \$24,000.00, plus funds sufficient to cover my charges and prorations herein, together with the note and deed of trust for \$70,000.00 set forth below, and the chattel mortgage, and I hand you herewith check for \$1000.00, all of which you will deliver when you obtain and record for me a deed to vestee and covering property described below, and when you can issue your usual form—standard form—policy of title insurance with liability not exceeding \$95,000.00 on all of Lot 2 and fractional Lots 1, 11 and 12 in Block 106, of the Bellevue Terrace Tract, in the City of and County of Los Angeles, State of California, being a Tract of land bounded as follows: On the North by the North line of said Lots 2 and 12 of said Block 106; on the East of Fremont Avenue and on the South and West by Sixth Street, as per map recorded in Book 2 Page 585 of Miscellaneous Records, showing title vested in Frank W. Babcock, an unmarried man.

Subject only to:

- (1) All taxes for the fiscal year 1945-1946.

(2) Covenants, conditions, restrictions, and easements of record: (Subject to approval of buyer.)

(3) Deed of trust to file, any form, executed by vestee above, securing a note for \$70,000.00, in favor of Call Estate Co., a corporation, with interest from date of note at  $4\frac{1}{2}\%$  per annum, principal and interest payable in installments of \$535.00 or more per month, until paid, payable at Los Angeles, California.

Said trust deed to recite that it is given to secure a portion of the purchase price of the property in question.

Said note is also secured by a chattel mortgage on personal property, given as additional security therefor.

Pro rate as of date of close of escrow the following:

(a) Taxes based on second half taxes for 1944-1945.

(b) Insurance premium on policy or policies as handed you.

(c) Rents on 30-day basis, based on statement to be handed you, which statement is subject to my approval.

Do not draw note, trust deed or chattel mortgage. My execution of all of said documents will evidence my approval in full of all terms, contents and provisions thereof.

Endorse interest on above note as paid to date of close of escrow.

Also obtain for delivery to me at close of escrow without additional consideration, a bill of sale covering certain personal property on the premises in question, per inventory attached, which bill of sale and inventory I reserve the right to approve. No chattel search required. Title Insurance and Trust Company is liable only for the delivery of said document at close of escrow.

Also obtain for delivery to me at close of escrow the following leases, together with assignments of the seller's interest therein, which leases I reserve the right to approve:

(1) Lease in favor of Boris Pollack and assigned to Oscar Plotkin and Aaron Gordon; and

(2) Lease in favor of Harry Rasnick.

Deliver title insurance policy to beneficiary.

Instruct Recorder to mail deed to me; trust deed & chat. mtg. to beneficiary. I pay your buyer's service fee as charged; recording deed \$1.00; mortgagee's clause on ins. 25 cents each.

### General Provisions

“All funds received in this escrow shall be deposited with other escrow funds in a general escrow account of Title Insurance and Trust Company with the Farmers and Merchants National Bank of Los Angeles. All disbursements shall be made by check of Title Insurance and Trust Company.

Recordation of any instruments delivered through this escrow, if necessary or proper in the issuance of the policy of title insurance called for, is authorized.

No examination or insurance as to the amount or payment of real or personal property taxes is required unless the real property tax is payable on or before the date of the policy of title insurance.

Execute on behalf of the parties hereto, form assignments of interest in any insurance policies (other than title insurance) called for herein and forward them upon close of escrow to the agent with the request, first, that insurer consent to such transfer or attach loss-payable clause or make such other additions or corrections as may have been specifically required herein, and second, that the agent thereafter forward such policies to the parties entitled to them. In all acts in this escrow relating to fire insurance, including adjustments, if any, you shall be fully protected in assuming that each such policy is in force and that the necessary premium therefor has been paid.

Time is of the essence of these instructions. If this escrow is not in condition to close by September 30, 1945, any party who then shall have fully complied with his instructions may, in writing, demand the return of his money and/or property; but if none have complied no demand for return thereof shall be recognized until five days after the escrow holder shall have mailed copies of such demand to all other parties at their respective addresses shown

in the escrow instructions. If no such demand is made close this escrow as soon as possible.

Any amendment of or supplement to any instructions must be in writing."

Buyer:

/s/ FRANK W. BABCOCK,  
834 So. Main,  
Los Angeles, California.

August 3, 1945.

Title Insurance and Trust Company:

I have read and approve the foregoing instructions. On or before September 30, 1945, I will hand you deed and bill of sale, together with the two leases and assignments, all as called for on page 1 hereof, which you will deliver when you can issue the policy of title insurance called for and collect for the account of the grantor the sum of \$25,000.00, and obtain and record for the undersigned the note for \$70,000.00 and deed of trust and chattel mortgage securing it as set forth on page 1 hereof.

Do not draw deed.

Pay at the close of escrow the sum of \$4250.00 to N. M. Saunders, 1109 I. N Van Nuys Building, Los Angeles, California; License No. 17317, as commission and debit the account of the undersigned accordingly.



The foregoing General Provisions are hereby incorporated in these instructions.

Pay all incumbrances of record necessary to place title in the condition called for. I will hand you any funds and instruments required for such purpose.

Deliver title insurance policy to us.

Instruct recorder to mail trust deed & chat. mtg to us; deed to grantee.

Begin search of title at once. I pay policy fee and escrow fee, both as charged; recording deed of trust & chattle mortgage. Internal Revenue Stamps of \$104.50, insurance transfers 25 cents each.

CALL ESTATE CO.

By /s/ [Indistinguishable.]



EXHIBIT "5-E"

FORM R.W.-1

Los Angeles California

July 21, 1949

ACCT.	DIST.	COUNTY	ROUTE	SECTION	ALLOW.
	VII	LA	165	LA	7RV50

ANK W. BABCOCK,

unmarried man,

Grantor

Station \_\_\_\_\_ to station \_\_\_\_\_

Side of Highway.

By *Clare Schuetzger*  
557295  
C Par No. 14

RIGHT OF WAY CONTRACT—STATE HIGHWAY

Document No. 785 in the form of a Grant Deed

ing the following described property:

Lots 1, 2, 11 and 12 in Block 106 of the Bellevue  
Terrace Tract, as per map recorded in Book 2,  
Page 585, of Miscellaneous Records of Los Angeles  
County, as more fully described in above-mentioned  
Grant Deed,

APPROVED

JUL 30 1949

BY *[Signature]*  
H.Q. R.W. OFFICE

been executed and delivered to E. F. KING

of Way Agent of the State of California.

In consideration of which, and the other considerations hereinafter set forth, it is mutually agreed as follows:

1. The parties have herein set forth the whole of their agreement. The performance of this agreement constitutes  
entire consideration for said document and shall relieve the State of all further obligation or claims on this account, or on  
ant of the location, grade or construction of the proposed public improvement.

2. The State shall:

(A) Pay the undersigned grantor the sum of \$207,323.34 for  
the property as conveyed by Grant Deed No. 785 within  
ety (90) days after date title to said property vests in the State  
e and clear of all liens, encumbrances, assessments and recorded  
/or unrecorded leasehold interests and easements except:

a. General and special City and County taxes for  
the fiscal year 1949-50, a lien not yet payable.

(B) Pay all escrow and recording fees incurred in this trans-  
action, and, if title insurance is desired by the State,  
premium charged therefor. Said escrow and recording charges shall not,  
ever, include reconveyance fees, trustee's fees, or forwarding fees.



3. Any or all moneys payable under this contract, up to and including the total amount of unpaid principal and interest on the note secured by deed of trust recorded October 11, 1945 in Book 22244, Page 323, Official Records of Los Angeles County, together with penalty (if any) for payment in full in advance of maturity, shall, upon demand, be made payable to the beneficiary entitled thereunder; said beneficiary to furnish grantor with good and sufficient receipt showing said moneys credited against the indebtedness secured by said deed of trust.

4. All rents shall be pro-rated as of October 31, 1949. All rents derived from said property up to and including said date shall be paid to the grantor and all rents paid for occupancy after said date shall be paid to the State of California. If any rentals on said property have been or are collected by the undersigned grantor for any period beyond said date, the undersigned grantor for any period beyond said date, the undersigned grantor shall immediately refund such rentals to the State.

5. The undersigned grantor hereby agrees and consents to the dismissal of Parcel No. 14, People vs. Clare Schweitzer, Superior Court Case No. 557295, Los Angeles County, and also waives any and all claims to any money that may have been deposited in the Superior Court in said action.

6. Grantor hereby <sup>and operated</sup> deliver up possession of premises <sup>now non-</sup>occupied by him, i.e., Elk Hotel, 947-949 West Sixth Street; Metropole Hotel, 931-933 West Sixth Street; and rooming house, 41-943 1/2 West Sixth Street by October 31, 1949 and, to that end, will immediately make application to the OPA for eviction of present tenants and take such other steps as will be necessary to deliver premises vacant on above date.

IN WITNESS WHEREOF, the parties have executed this agreement the day and year first above written.

Frank W. DeLoach

C/O N. W. Saunders Co.  
1109 I. N. Van Nuys Bldg.  
~~834 South Main Street~~  
Los Angeles, California

Grantor

Recommended for Approval, [Signature]  
Right of Way Agent

Recommended for Approval, H. W. Leonard  
Metropolitan District Right of Way Agent

STATE OF CALIFORNIA  
DEPARTMENT OF PUBLIC WORKS  
DIVISION OF HIGHWAYS  
By [Signature] Asst. District Engineer

No Obligation Other Than Those Set Forth Herein Will Be Recognized

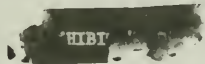






EXHIBIT "6-F"

County: LA

Route: 165

Section: LA

Parcel No.: 785—Babcock

Received from the State of California, Dept. of Public Works, Division of Highways, Check No. Y78771, in the amount of \$149,750.71, covering payment in accordance with Right of Way Contract dated July 21, 1949.

/s/ FRANK W. BABCOCK.

Dated at Los Angeles, California, November 9, 1949.

Filed at hearing January 10, 1957.

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[Title of Tax Court and Cause.]

ADDITIONAL STIPULATION OF FACTS

It is stipulated that the following facts may be received in evidence without further proof; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts stipulated; and provided, further

that both parties to this stipulation reserve the right to object to the materiality and relevancy of any of the facts herein stipulated.

11. Section 580b, Code of Civil Procedure for the State of California, provides as follows:

“No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale or under a deed of trust, or mortgage, given to secure payment of the balance of the purchase price of real property.

“Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof.”

12. Section 580d, Code of Civil Procedure for the State of California, provides in part as follows:

“No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property hereafter executed in any case in which the real property has been sold by the mortgagee or trustee under power of sale contained in such mortgage or deed of trust. \* \* \*”

13. That the amount of depreciation claimed by petitioner in his federal income tax returns for the years 1945, 1946, 1947, 1948 and 1949 was the sum

of \$8,166.66 of which the sum of \$8,000.00 was allowed by Respondent.

/s/ AUSTIN CLAPP,  
Counsel for Petitioner.

/s/ JOHN POTTS BARNES, R.E.M.  
Chief Counsel, Internal Revenue Service, Counsel  
for Respondent.

Filed at hearing January 10, 1957.

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In the United States Court of Appeals  
for the Ninth Circuit

T. C. Docket No. 55993

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner on Review,

vs.

FRANK W. BABCOCK,  
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judge of the United States Court  
of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on September 4, 1957, ordering and deciding that there is a

deficiency in income tax in the amount of \$4,161.77 for the taxable year 1949 and additions to tax under section 293(a), Internal Revenue Code of 1939, in the amount of \$727.40. This petition for review is filed pursuant to the provisions of sections 7482 and 7483 of the Internal Revenue Code of 1954.

The respondent on review (hereinafter referred to as the taxpayer) resides at 501 S. Los Angeles Street, Los Angeles, California. The taxpayer filed his income tax return for the calendar year 1949 with the Collector of Internal Revenue at Los Angeles, California, and within the judicial circuit of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

### Nature of Controversy

The question involved is whether the gain of a taxpayer whose property is taken pursuant to condemnation proceedings is recognized to the extent of an amount retained by the Government and used to pay taxpayer's note secured by a mortgage against the property.

The substance of taxpayer's argument against the recognition of any gain arising out of the condemnation award is that his interest in the property and the interest of the mortgagee were several interests, that he sold only his interest, and that the amount he realized for his interest was fully re-invested in similar property; hence under section 112(f) of the 1939 Internal Revenue Code there was no recognizable gain.



The Commissioner took the position that the word “property” as used in section 112(f), relating to involuntary conversions, does not mean merely taxpayer’s equitable interest, but also includes amounts used to pay taxpayer’s note secured by a mortgage against the involuntarily converted property under section 29.112(f)-1 of Treasury Regulations 111 and *Fortee Properties, Inc., v. Commissioner* (C.A. 2, 1954) 211 F.2d 915; 45 A.F.T.R. 1347, with the result that the gain is recognizable to the extent of such amount.

/s/ CHARLES K. RICE, C.A.R.  
Assistant Attorney General.

/s/ NELSON P. ROSE, C.A.R.  
Chief Counsel, Internal Revenue Service, Counsel  
for Petitioner on Review.

Received and filed November 25, 1957, T.C.U.S

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[Title of Court of Appeals and Cause.]

T. C. Docket No. 55993

### STATEMENT OF POINTS

Comes Now the petitioner on review herein and makes this concise statement of points on which he intends to rely on the review herein, to wit:

The Tax Court of the United States erred:

1. In holding that failure of the taxpayer to invest in similar property the amount of money re-

tained by the Government in condemnation proceedings and used to pay taxpayer's note secured by a mortgage against the condemned property, did not justify recognition of gain to the taxpayer.

2. In failing to hold that taxpayer's failure to invest in similar property the amount of money retained by the Government in condemnation proceedings and used to pay taxpayer's note secured by a mortgage against the condemned property, rendered the gain taxable to the extent of such amount.

3. In holding that there is a deficiency in income tax for the year 1949 in the amount of \$4,161.77 and additions to tax under section 293(a), Internal Revenue Code of 1939, in the amount of \$727.40.

4. In failing to hold that there is a deficiency in income tax for the year 1949 in the amount of \$15,323.09 and additions to tax under section 293(a), Internal Revenue Code of 1939, in the amount of \$992.38.

5. In that its opinion and decision are contrary to law and regulations and are not supported by its finding of fact or substantial evidence.

/s/ CHARLES K. RICE, C.A.R.  
Assistant Attorney General.

/s/ NELSON P. ROSE, C.A.R.  
Chief Counsel, Internal Revenue Service, Counsel  
for Petitioner on Review.

Received and filed November 25, 1957, T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 12, inclusive, constitute and are all of the original papers on file in my office as called for by the "Designation of Contents of Record on Review," including joint exhibits 1-A thru 6-F, attached to the Stipulation of Facts, in the case before the Tax Court of the United States docketed at the above number and in which the Respondent in the Tax Court has filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case, as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 10th day of February, 1958.

[Seal]      /s/ HOWARD P. LOCKE,  
Clerk, Tax Court of the  
United States.

[Endorsed]: No. 15888. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Frank W. Babcock, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: February 17, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the  
Ninth Circuit.

In the United States Court of Appeals  
for the Ninth Circuit

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

FRANK W. BABCOCK, RESPONDENT

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On Petition For Review of The Decision of The  
Tax Court of The United States

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BRIEF FOR THE PETITIONER

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CHARLES K. RICE,  
*Assistant Attorney General.*

LEE A. JACKSON,  
ROBERT N. ANDERSON,  
LOUISE FOSTER,  
*Attorneys,  
Department of Justice,  
Washington 25, D. C.*

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FILED

MAY 1934

PAUL P. C. 1934





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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 15,888

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

FRANK W. BABCOCK, RESPONDENT

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On Petition For Review of The Decision of The  
Tax Court of The United States

---

BRIEF FOR THE PETITIONER

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**OPINION BELOW**

The opinion of the Tax Court (R. 5-20) is reported at 28 T.C. 781.

**JURISDICTION**

The Commissioner determined a deficiency in the taxpayer's income tax for 1949 in the amount of \$15,323.09 and an addition thereto under 1939 Code Section 293(a) in the amount of \$992.38. (R. 6.) On January 18, 1955, which was within the ninety-day period allowed by the statute, the taxpayer filed a petition in the Tax Court for redetermination of

such deficiency under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3.) After the hearing, the Tax Court decided on September 4, 1957, that there is a deficiency in income tax only in the amount of \$4,161.77 for 1949, and also decided there should be additions to tax under Section 293(a) in the amount of \$727.40. (R. 21.) Within three months thereafter, i.e., on November 25, 1957, a petition for review by this Court was filed by the Commissioner. (R. 37-39.) Jurisdiction of this Court is invoked under Section 7482 of the Internal Revenue Code of 1954.

### QUESTION PRESENTED

Whether the taxpayer realized taxable gain under 1939 Code Section 112(f) to the extent of the difference between the total award paid upon the condemnation of the taxpayer's property and a smaller amount subsequently invested by the taxpayer in replacement property. This depends on whether the taxpayer, who was not personally liable on the mortgage covering the condemned property and who actually did not receive the amount used to pay off the mortgage must treat the whole amount of the award as the selling price, as the Commissioner determined; or is required to treat only the amount of his equity in the property as such price (which was less than the amount he reinvested), as the Tax Court held.

### STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions and regulations appear in the Appendix A, *infra*.



## STATEMENT

The facts so far as pertinent to the issue here were found by the Tax Court as follows (R. 7-9) :

In October, 1945, the taxpayer purchased real estate known as the Elk Metropole Hotel in Los Angeles at a total cost of \$89,600 and at the time of purchase he executed a promissory note secured by a mortgage, covering the land and building, in the amount of \$70,000. On November 9, 1949, unpaid principal and interest on that note aggregated \$57,572.63. Interest which had already been paid was claimed and allowed as a deduction on income tax returns filed during that period. (R. 7.)

On November 9, 1949, the State of California acquired the Elk Metropole Hotel under condemnation proceedings and pursuant to a formal contract with the taxpayer agreed that the selling price would be \$207,323.34. At the same time and in accordance with the contract the State paid the mortgagee \$57,572.63 (which was the balance due on the note) and paid the remainder of the selling price or \$149,750.71, to the taxpayer. (R. 7-8.)

In March, 1950, the taxpayer made an informal application to establish a replacement fund and on July 7, 1950, while such application was still pending, the taxpayer purchased the Sherwood Apartment Hotel as a replacement of the Elk Metropole Hotel. The purchase price of the replacement property was \$186,125 of which \$149,750.71 was paid by taxpayer in cash from the money received from the State for the other hotel. (R. 8.)

In his notice of deficiency, the Commissioner held that since only \$186,125 was spent by the taxpayer for similar property and \$207,323.34 has been paid as the total condemnation award, the difference between these two figures should be treated as gain (i.e., long term capital gain); and so he increased the taxable income by one half of the resulting figure or by \$10,599.17. (R. 8-9.)

The Tax Court refused to approve the Commissioner's determination, and held that no part of the condemnation award constituted a taxable gain. (R. 16.) Two other issues were decided for the Government and need not be considered here.

#### STATEMENT OF POINTS TO BE URGED

1. The Tax Court erred in holding that failure of the taxpayer to invest in similar property the amount of money retained by the State Government in condemnation proceedings and used to pay taxpayer's note secured by a mortgage against the condemned property did not justify recognition of gain to the taxpayer.

2. The Tax Court erred in failing to hold that there is a deficiency in income tax for the year 1949 in the amount of \$15,323.09 and additions to tax under Section 293(a), Internal Revenue Code of 1939, in the amount of \$992.38.

3. The Tax Court's opinion and decision are contrary to the law and Regulations pertinent thereto.

#### SUMMARY OF ARGUMENT

Taxpayer realized taxable gain upon the condemnation of his hotel by the State of California unless the

transaction falls within the non-recognition provisions of the statute, which require that all the money paid by the purchaser upon the conversion of the property into cash be used for acquiring suitable replacement property forthwith. Consequently, as the record shows that part of the award was not used in the acquisition of the replacement property, the statutory requirement has not been met and gain, to the extent of the money not so used, must be recognized for income tax purposes.

This view is in accord with the long standing Regulations which now have the force of law and which provide that the amount of the net award shall include any sum retained by the Government to satisfy any mortgages on the property even if the Government pays the mortgagee itself. These Regulations have been approved and followed in the applicable decisions of the Court of Appeals. But the Tax Court tried to avoid the implication of these decisions by holding here that the principle announced therein should be applied only in cases where the taxpayer has assumed the mortgage and can not be applied in this case because the taxpayer has no personal obligation for the mortgage debt under California law. There is no basis for such a distinction in the broad language of the statute and Regulations. Moreover when viewed from the practical standpoint, the economic effect upon the taxpayer's property is the same regardless of whether he has assumed the mortgage. It should also be noted that in either case, the taxpayer is entitled to use as a basis for depreciation the full amount of the property which means that he can include the

amount of the mortgage. Thus the Tax Court was in error in treating taxpayer's property as equalling only his equity therein. Such a definition of property has not only been repudiated in cases involving condemnation awards but also by the Supreme Court in *Crane v. Commissioner*, 331 U.S. 1, where it was held, in determining the amount of gain realized on an ordinary sale of mortgaged property, that the "property" was not to be diminished by the amount of an unassumed mortgage.

The Commissioner's determination is also supported by the Congressional Committee reports which discuss the statutory provision applicable here. In objecting to that determination, the taxpayer has relied primarily on a decision of this Court which involves depreciation claimed by a lessor on a building erected by the lessee under a 99 year lease. As this Court properly held, the taxpayer in that case had no wasting asset and could not show the required economic loss but in reaching its conclusion, this Court recognized that the facts there were distinguishable from those in the *Crane* case, and indicated that the term "property" may be given the definition for which we contend here.

### ARGUMENT

**The Tax Court Erred in Failing to Hold That The Taxpayer Realized Taxable Gain During The Taxable Year From The Condemnation Award**

It is admitted that the Elk Metropole Hotel, which taxpayer purchased in 1945, was converted as a result of condemnation proceedings in 1949 into money in excess of his adjusted cost basis. Thus taxable gain



was necessarily realized by the taxpayer at that time unless the transaction falls within the non-recognition provisions of Section 112(f) of the Internal Revenue Code of 1939, Appendix A, *infra*, which are an exception to the general rule in providing that no gain shall be recognized if the condemned property is converted into money which is—

forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, \* \* \*. If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain).

We submit that the purpose of Section 112(f) is to defer, not to exempt, gain realized involuntarily by such events as condemnation proceedings and then only when the indicated statutory requirements have been fully met, but as we shall show, the requirements have not been met in this case and the Tax Court's decision is wrong.

**A. *The Tax Court's decision is contrary to the established administrative and judicial construction of Code Section 112(f)***

The record shows that under the condemnation proceedings, the State of California paid \$207,323.34



for the taxpayer's hotel but in acquiring suitable replacement property (i.e., the Sherwood Apartment Hotel) the taxpayer spent only \$186,125. (R. 7-8, 24-25.) Thus it follows, as the Commissioner determined, that since, in the language of Section 112(f), "part of the money" (i.e., the difference between the two amounts just referred to or \$21,198.34) was "not so expended, the gain" (which is admitted to be \$125,723.34 (R. 9)) "shall be recognized to the extent of the money \* \* \* not so expended \* \* \*".

This is in accord with the long standing administrative construction of the statute embodied in Treasury Regulations. Section 29.112(f)-1 of Regulations 111 provides (Appendix A, *infra*):

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments \* \* \*) and mortgages against the property and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. \* \* \*

These Regulations, promulgated under the specific statutory authority found in Section 112(f) have been in force for nearly 24 years<sup>1</sup> and are entitled, by

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<sup>1</sup> The provision first appeared in Art. 112(f)-1, Treasury Regulations 86, promulgated under the Revenue Act of 1934. The Regulations were preceded by five years by a similar administrative interpretation by the Bureau of Internal Revenue. See G.C.M. 5302, VIII-1 Cum. Bull. 197 (1929), ruling that "money" received in payment for property taken by condemnation proceeding includes, under the antecedent of Section 112(f), in the Revenue Act of 1924, the amount deducted from the award to pay an indebtedness to the Government.

virtue of the successive reenactments of Section 112 (f) without change, to be regarded as law. Basically, the reason for this interpretation of the statute lies in the requirement that the money into which the property is converted be expended for the statutory purposes. Thus the Regulations also provide (Appendix A, *infra*) :

In order to avail himself of the benefits of section 112(f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. \* \* \*

Obviously, where a portion of the money into which the property is converted is used to discharge a mortgage indebtedness on such property it is not used in the acquisition of other similar property.

The courts have expressly so held. *Commissioner v. Fortee*, 211 F. 2d 915 (C.A. 2d), certiorari denied, 348 U.S. 826; *Ovider Realty Co. v. Commissioner*, 193 F. 2d 266 (C.A. 4th); *Kennebec Box and Lumber Co. v. Commissioner*, 168 F. 2d 646 (C.A. 1st). The reasoning of the court in the *Kennebec* case applies directly to the facts here. The court said (p. 648) :

The payment, from the insurance proceeds, of the mortgage and the use of part of the fund for taxpayer's general business purposes can hardly

be regarded as temporary investments of portions of this fund. These payments were not "investments" at all in any normal sense of that word; they were, on the contrary, final and irrevocable expenditures of this money for purposes utterly foreign to the acquisition of property similar to, or related in use to, the property destroyed.

The tracing provisions of the Regulations, which make explicit what is inherent in the language of the statute, have been sustained in numerous cases in addition to those cited above. See *Vim Securities Corp. v. Commissioner*, 130 F. 2d 106, 109 (C.A. 2d), certiorari denied, 317 U.S. 686; *Commissioner v. Flushingside Realty Co.*, 149 F. 2d 572 (C.A. 2d), certiorari denied, 326 U.S. 754; *Twinboro Corp. v. Commissioner*, 149 F. 2d 574 (C.A. 2d), certiorari denied, 326 U.S. 754; *Winter Realty & Const. Co. v. Commissioner*, 149 F. 2d 567 (C.A. 2d), certiorari denied, 326 U.S. 754.

Both the taxpayer and the Tax Court seek to avoid the implication of these decisions and the Regulations by suggesting that they apply properly only to mortgages which have been assumed by a taxpayer and are his personal obligation. But this distinction has no support in the broad language of the Code section or the Regulations nor can it be justified by the alleged practical difference between the taxpayer's personal obligation with respect to the mortgage debt in the one case and the mere economic burden on the property in the other. In both instances a condemnation award may be distributed partially in payment of the mortgage without regard to the taxpayer's wishes. In both cases the economic effect *upon the taxpayer's*

“*property*” is the same and the taxpayer realizes his admitted gain in the most concrete economic fashion, namely, by the conversion of his property into money. In neither is there any reason for postponement of the tax on such gain.

Moreover, even considered in purely practical terms, there is no significant difference. Normally, the same price is paid for property whether the mortgage is assumed or not, especially where, as in the instant case, the value of the property exceeds the amount of the mortgage. In both cases it will be the taxpayer who alone will gain by the increase in the market value of the property and its conversion into money. Furthermore, whether assumed by him or not, if he wishes to avoid foreclosure, the taxpayer must meet the periodic payments on the mortgage. Similarly in both cases, if the taxpayer wishes to rid his property of the burden of the mortgage or avoid sacrificing his property should the market fall, he must see to it that the mortgage is satisfied. An even more important consideration is that in either case the taxpayer, as we will develop in greater detail elsewhere in this brief, is entitled to depreciation on the full amount of his basis, which in each instance will include the value of the mortgage.<sup>2</sup>

The Tax Court's basic error stems from its analysis of the transaction here in such a way as to underestimate the amount of money for which the tax-

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<sup>2</sup> Here, the taxpayer in slightly fore than four years had already taken depreciation on the hotel in the amount of \$8,000, as compared with his original cash investment of \$19,600. (R. 9.)



payer's condemned property was converted. In other words, it was the Tax Court's position that the taxpayer's "property" was converted for the sum of \$149,750.71 (i.e., the difference between the sales price and the amount due on the mortgage when the condemnation occurred.) Obviously this conclusion was based on the assumption that the term "property" as used in Section 112(f) means only the taxpayer's equity in the hotel, and that, as the Tax Court pointed out (R. 11), was also the basis for its decision (19 T.C. 99) in the case of *Fortee Properties, supra*, but it was overruled by the Second Circuit. Since the latter's opinion gives an excellent explanation of Section 112(f) and the facts there are very similar to those here, we take the liberty of quoting from it at length. The court there said (p. 916):

The tacit assumption essential to the court's decision is that the word "property" in § 112(f) of the Internal Revenue Code means no more than the taxpayer's equitable interest in the land and the buildings. We disagree. In our view, the decision here should be governed by the rationale of *Crane v. Commissioner*, 331 U.S. 11, interpreting the meaning of "property" under § 113 of the Internal Revenue Code, 26 U.S.C.A. § 113. The *Crane* case involved the computation of tax gain on the sale of depreciable property subject to a non-assumed mortgage. The Supreme Court held the value of the mortgage must be included in determining the base and the amount realized on the sale. *The decision, distinguishing the words "property" and "equity", reasoned that "property" could not be restricted to mean merely the owner's rights over and above encumbrances.*



While the *Crane* case can literally be distinguished as involving a different section and a different type of transaction, we think both the reasoning and spirit of the opinion are applicable here. The basis of the taxpayer's argument here is that, since he was not personally liable on the mortgage, he received no benefit and, hence, no gain on the satisfaction of the mortgage by payment to the mortgagee. This contention was rejected in the *Crane* case as to a transfer of property subject to a non-assumed mortgage. There the Court said that one "not personally liable on the debt, who sells the property subject to the mortgage and for an additional consideration, realizes benefit in the amount of the mortgage \* \* \*." *Similarly, satisfaction of a non-assumed mortgage, by payment to the mortgagee, benefits taxpayer in the case at bar. In practical terms, for the purpose of protecting his property from foreclosure, where the value of the property is greater than the amount of the mortgage, the taxpayer-mortgagor has to treat the obligations of a non-assumed mortgage as if they were his personal obligations. Payments to the mortgagee relieved the owner of this necessity. (Italics supplied.)*

*Crane v. Commissioner*, 331 U.S. 1, to which the Second Circuit referred, required a determination of the gain "realized" under 1939 Code Section 111(a) and (b) (Appendix A, *infra*) from the "sale or other disposition of property" which the taxpayer inherited, subject to a mortgage. This, in turn, required a determination of the unadjusted basis of the property under Code Section 113(a) (5). (Appendix A, *infra*.) Both uses of the term "property," the Supreme Court

held, meant the owner's legal rights in the land and buildings sold, undiminished by the mortgage, and not the taxpayer's "equity" in them. Specifically the Supreme Court held (1) that the word "property" should be interpreted in its ordinary every day sense unless there are strong countervailing considerations which would support a different contention (331 U.S. p. 6); (2) that in other parts of the Code Congress has not confused the use of the words "property" and "equity" or made them interchangeable (p. 8); (3) that the word "property" should be construed so as to make such construction consistent with the depreciation and collateral basis adjustment sections (pp. 9-10) and (4) that in construing the "amount realized" and the word "property" it is immaterial whether the seller is or is not personally liable on the mortgage (p. 13).

Each of these considerations is pertinent to this case and the Tax Court's attempt to distinguish them falls far short of the mark. The word "property" in Section 112(f) was used in the same ordinary, everyday sense as was used in Sections 111 and 113. Here, just as in the *Crane* case, the functional relationship between Section 112(f) and the depreciation sections (1939 Code Sections 23(l) and (n) and 114(a)) provides additional support for our views. Under these sections, the basis for depreciation is the basis provided in Section 113(b) for the purpose of determining gain upon the sale of the property, which, in turn, is the Section 113(a) basis adjusted for depreciation. The *Crane* decision conclusively holds (1) that the unadjusted basis under Section 113(a) is the

cost<sup>3</sup> of the property *undiminished by the amount of a mortgage*, whether or not the mortgage is personally assumed by the owner of the property and (2) the depreciation allowance is computed on the full amount of this basis. (We do not believe this is open to argument or that the taxpayer will contest it. Indeed, as the record shows (R. 8-9) depreciation here was taken by the taxpayer in four years in the amount of \$8,000 as compared with the taxpayer's original cash investment of \$19,600.) Thus, for depreciation purposes and for the purpose of computing gain or loss on a sale, the mortgage will be included in the taxpayer's "basis" and in any "amount realized."

Since the Tax Court interprets the term "property" in Section 112(f) as including the mortgage in cases where the mortgage debt has been assumed by the taxpayer, it is difficult to see how it can insist that the term "property" be limited to "equity" where the mortgage has not been assumed. Indeed, it must be recognized that in this sense the Tax Court is reverting to its *Crane* decision (3 T.C. 585) which the Supreme Court ultimately rejected when it said (331 U.S., p. 14):

\* \* \* we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage

---

<sup>3</sup> More accurately, since the *Crane* case involved property acquired by bequest, the holding therein was that the basis of such property was its fair market value (under Section 113(a)(5)) rather than cost. However, the *Crane* rule applies with equal force to purchased property. *Blackstone Theatre Co. v. Commissioner*, 12 T.C. 801.

as well as the boot. If a purchaser pays boot, it is immaterial as to our problem whether the mortgagor is also to receive money from the purchaser to discharge the mortgage prior to sale, or whether he is merely to transfer subject to the mortgage—it may make a difference to the purchaser and to the mortgagee, but not to the mortgagor. Or put in another way, *we are not more concerned with whether the mortgagor is, strictly speaking, a debtor on the mortgage, than we are with whether the benefit to him is, strictly speaking, a receipt of money or property. We are rather concerned with the reality that an owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were his personal obligations. If he transfer subject to the mortgage, the benefit to him is as real and substantial as if the mortgage were discharged, or as if a personal debt in an equal amount had been assumed by another. [Italics supplied.]*

We submit that the logic of the observations just quoted demonstrates beyond question the lack of merit in the Tax Court's view that the only "property" of the taxpayer which was converted amounted to \$149,750.71.

***B. The Legislative history of Section 112(f) supports the Commissioner's determination***

The Tax Court stated (R. 13) that, in deciding that no taxable gain had been realized as a result of the condemnation award, it had not overlooked statements made by the Congressional Committees in connection with Sections of the Act of October 31, 1951, c. 661, 65 Stat. 733, which amended Section 112(f)



prospectively. But we submit that the Tax Court failed to give full meaning to those reports inasmuch as they support our position here. In discussing the proposed changes in Section 112(f) both the House Ways and Means Committee and the Senate Finance Committee stated in identical language (H. Rep. No. 798, 82d Cong., 1st Sess., pp. 1-2; and S. Rep. No. 1052, 82d Cong., 1st Sess., pp. 1-2) that:

While section 112(f) of the code now operates in the majority of cases to relieve taxpayers from the payment of tax upon gain where property has been involuntarily converted, the requirements of this provision have operated to deny relief in some cases where your committee believes that relief should be granted. No relief is accorded under existing law where, before receipt of the proceeds for the converted property, the taxpayer purchases replacement property. Relief is denied in these anticipatory replacement cases since the benefits of section 112(f) are limited to those cases in which the proceeds from the converted property can be directly traced into the subsequently acquired property. A problem also arises under the present law where the taxpayer uses a part of the proceeds from the converted property to pay off indebtedness on the converted property. In such a case the taxpayer is denied the benefits of section 112(f), *that is the taxpayer must pay a tax on any gain from the converted property up to the amount of the proceeds which are used in liquidation of indebtedness on the converted property, even though he also fully replaces the converted property, since the amount used to pay off the indebtedness cannot be directly traced into the replacement property.* (Italics supplied.)



From the above excerpt, it is evident that Congress did not draw any distinction between the payment of mortgage debts which have been assumed and those which have not been assumed by the taxpayer. Thus these Committee reports indicate that Congress intended to approve the Commissioner's interpretation of Section 112(f) and to make it applicable as to all transactions occurring before December 31, 1950. The Tax Court's reason for holding otherwise, as we have pointed out, was that the mortgage here had not been assumed by the taxpayer but as we have already shown under subheading A, *supra*, the fallacy in this approach we believe it unnecessary to discuss this point further.

However, it should be noted here that in support of its interpretation of the Congressional reports the Tax Court cited *Kennebec Box & Lumber Co. v. Commissioner, supra*, and *Ovider Realty Co. v. Commissioner, supra*. In neither of these cases was it stated, as the Tax Court did here, that a distinction should be made between mortgages which are assumed and those which are not assumed by the taxpayer. Indeed the opinions in those cases do not indicate specifically that the mortgages there had been assumed by the taxpayers. However, even if they are so construed, the principle announced therein was stated in such general language that it is clearly applicable here and does not support the Tax Court's decision. This is shown by the *Ovider Realty Co.* case in which the Fourth Circuit said (p. 269):

And it has been held that the gain is taxable when, as in the pending case, the insurance

money is used to pay a mortgage debt on the destroyed property or to pay a debt owing by the taxpayer to a bank, even though the destroyed property is subsequently restored and the taxpayer's financial ability to restore it is enhanced by the receipt of the proceeds of the insurance.

\* \* \* \*

Then, after citing most of the cases which we have cited herein, the Fourth Circuit pointed out that, "This line of authority" (p. 269) was recently recognized by the Congressional reports, which we have also referred to as supporting our contention here.

*C. The contention of the taxpayer is not supported by the decision of this Court on which he has relied*

In the Tax Court, the taxpayer relied primarily on *Commissioner v. Moore*, 207 F. 2d 265 (C.A. 9th), particularly this Court's statement where, in referring to the word "property" as used in 1939 Code Section 113(a) (5), it said (p. 268):

But "such property" is not the steel frame, brick and terra cotta loft and store building on the corner of Figueroa, Seventh and Flower Streets in the City of Los Angeles,—it is the taxpayer's *interest* in that property. And her interest is a limited one, not only because it is a fractional part, but also because it is subject to the lease. As the Tax Court said, dealing with another point in this case: "What petitioner inherited from her mother was an undivided half interest in the land under the Barker Bros. building *and a reversionary interest in the building.*" (Italics supplied.)

Taxpayer has argued and doubtless will continue to argue that such statement indicates the correctness of his major contention, namely, that the several properties of the mortgagor (i.e., the taxpayer) and of the beneficiary or mortgagee were severally converted into money pursuant to the condemnation proceeding, and that the former received only \$149,750.71 for his property and reinvested all of it.<sup>4</sup> We do not, of course, agree.

Obviously this Court's statement in the *Moore* case must be considered in the light of the question and facts involved there. In that case taxpayer and her mother owned land which they leased for 99 years to a company which agreed to erect a building thereon. When the mother died some years later, her interest in such property passed to the taxpayer who, in subsequent years, claimed that she was entitled to take deductions on account of depreciation attributable to a one half interest in the building (i.e., the interest inherited from her mother). These were allowed by the Tax Court but this Court reversed its decision. In doing so, this Court said that although taxpayer might have acquired a basis for depreciation under Section 113(a)(5), she did not inherit an interest in a wasting asset. In other words what she got was her mother's reversionary interest in a building which would have no value after 99 years, and her

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<sup>4</sup> Taxpayer has also argued that because of the effect of California law, this case is distinguishable from the *Fortee* case, *supra*; and the Tax Court also discussed California law. (R. 15-16.) But we think there is no material distinction in the two cases and that what we have said under subheading A answers this contention.

mother's interest in the ground rentals which would not be affected in any way by the deterioration of the building. But depreciation deductions were allowed to the lessee over the life of the building. In this connection this Court discussed *Crane v. Commissioner, supra*, which the Tax Court refused to follow here. It said (p. 272):

The circumstances just mentioned disclose one reason why *Crane v. Commissioner*, 331 U.S. 1, \* \* \* upon which taxpayer relies, does not support the Tax Court's decision on this point. There the Supreme Court held that one who inherited an apartment house worth \$262,000, subject to a mortgage of \$262,000, was chargeable with an amount of gain on resale which was arrived at on the assumption that the mortgagor could take depreciation on the value of the building, notwithstanding her equity was zero. *But there, as the Court was careful to point out, the mortgagor remained in possession, the mortgagee could not take depreciation, and unless the mortgagor could take it, the effect would be to "deny deductions altogether."* Here, to disregard taxpayer's limited interest, and permit her to take depreciation on the full value of the building, while lessee is properly claiming deductions based on the same values, would result in having deductions taken on the same building's depreciation twice. (Italics supplied.)

We submit that in making the above statement this Court was in effect announcing that a taxpayer who owns and is in possession of mortgaged property (regardless of whether he has assumed the mortgage) is to be treated as the owner of the entire property

and can deduct the entire amount allowable by statute for deterioration of the property rather than the portion which might be assigned to his equity therein. Thus it is evident that the *Moore* case does not attempt to limit the word "property" as the Tax Court has done in this case and does not preclude the adoption of the Commissioner's interpretation of Section 112(f). Moreover it did not involve a mortgage debt.

### CONCLUSION

The decision of the Tax Court is erroneous and should be reversed.

Respectfully submitted,

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May , 1958



## APPENDIX A

## Internal Revenue Code of 1939:

SEC. 111. DETERMINATION OF AMOUNT OF, AND  
RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money received).

\*       \*       \*       \*

(26 U.S.C. 1952 ed., Sec. 111.)

## SEC. 112. RECOGNITION OF GAIN OR LOSS.

\*       \*       \*       \*

(f) [as amended by Sec. 151(d) and (e) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Involuntary Conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat of imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the ac-

quisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain shall be recognized, but loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain).

\* \* \* \*

(26 U.S.C. 1952 ed., Sec. 112.)

### SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

\* \* \* \*

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent, the basis shall be the fair market value of such property at the time of such acquisition.

\* \* \*

\* \* \* \*

(9) *Involuntary Conversion.*—If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion, described in section 112(f) (1) or (2), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable

to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made. \* \* \*

\* \* \* \*

(26 U.S.C. 1952 ed., Sec. 113.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.112(f)-1. *Reinvestment of Proceeds of Involuntary Conversion*.—Upon the involuntary conversion of property described in section 112 (f), no gain is recognized if the provisions of that section are complied with. If any part of the money received as a result of such an involuntary conversion is not expended in the manner provided in section 112(f), the gain, if any, is recognized to the extent of the money which is not so extended. \* \* \*

\* \* \* \*

In order to avail himself of the benefits of section 112(f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property con-

verted. The benefits of section 112(f) cannot be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

\* \* \* \*

## APPENDIX B

Table of Exhibits pursuant to Rule 18(2)(F) as amended.

<u>Exhibits</u>	<u>Set forth in printed record</u>	<u>Identified, offered and received</u>
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5-E	R. 32 - 33	R. 24
6-F	R. 35	R. 24





No. 15888

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,

*Petitioner,*

*vs.*

FRANK W. BABCOCK,

*Respondent.*

---

## RESPONDENT'S BRIEF.

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**FILED**

**JUN - 6 1958**

**PAUL P. O'BRIEN, CLERK**



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---

## RESPONDENT'S BRIEF.

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### Statement.

Respondent does not quarrel with the Statement of Petitioner except insofar as it says that the taxpayer executed a *mortgage* and that the State, in the condemnation proceedings paid certain moneys to the *mortgagee*. [R. 3.]

In fact, as shown by the stipulation of facts [R. 23, par. 5], Exhibits 4-D [R. 27, par. 3] and 5-E [R. 33, par. 3] the document executed was a purchase money trust deed. The Tax Court recognized this fact [Opinion, R. 7, second par.] but chose to rest its decision upon grounds unaffected by the distinction between a California purchase money trust deed and a mortgage. As we shall develop, California property law is such as to make it important that taxpayer executed a purchase money trust deed.

### Question Presented.

Whether or not the interest of a California Trustor in real property as to which a purchase money trust deed was executed is the "property" which was "converted into money" in a condemnation proceeding so that where all of the money into which it was converted was reinvested in property "similar or related in use or service" no gain on an involuntary conversion should have been recognized and no deduction or adjustment should have been made as a result thereof to an established net operating loss for the year following the involuntary conversion?

### Statement of Points to Be Urged.

The decision of the Tax Court was and is correct.

Interests of the trustor and of the beneficiary in the real property involved in the involuntary conversation were several interests in real estate. Each of the several interests was converted into money. All of the money into which the trustor's (Respondent's) property was converted was reinvested in property similar or related in use or service to the property converted. No gain should have been recognized by the Commissioner and no adjustment should have been made to Petitioner's net operating loss in the ensuing year as the result of this transaction.

*C. I. R. v. Fortee Properties, Inc.* (C. A. 2), 211 F. 2d 915, was wrongly decided and is not controlling or persuasive.

## ARGUMENT.

### A. The Interests of Trustor and Beneficiary in the Real Property Involved Were Separate Interests in Real Estate and Were Separately Converted Into Money.

Under the law of the State of California trustor and beneficiary in a transaction involving a conveyance of land and the co-terminous execution of a note and purchase money trust deed are co-owners of interests in real estate.

“ . . . the seller who takes back only a note secured by a trust deed has nothing to which he can resort but the land *and in a real sense has converted his entire ownership into a lesser interest in the real estate*. The conveyance to the buyer and the purchase money trust deed cannot be divorced; they come into being simultaneously and must be viewed realistically as a single transaction.”

*Moore's Estate*, 135 Cal. App. 2d 122, 286 P. 2d 939, 944.

The position of trustor and beneficiary is thus analogous to that of tenants in common in real property whose several interests may be, in a condemnation proceeding, “property” which is “converted into money.” (I. R. C., Sec. 112(f)(2), 26 U. S. C. (1952 Ed.), Sec. 112(f)(2).)

What does the interest of the trustor in such a transaction consist of? He has received, and has conveyed to the trustee the legal title to the property; he has the right of possession, the right to receive and retain the rents, issues and profits, and the right either to complete the purchase or to abandon the transaction without personal liability for any balance of purchase price.

We concede that depreciation allowances are based upon the cost of the property, undiminished by the amount of unpaid purchase price, whether secured by mortgage or otherwise. This is done because the statute says it shall be done. (I. R. C., Sec. 113(a); 26 U. S. C. (1952 Ed.), Sec. 113(a).) But the *cost* of the trustor's limited interest is the full purchase price to be paid if he exercises his right to complete the purchase, not the down payment he may, or may not make. Hence there is no incongruity in the trustor's having taken a depreciation allowance relatively large in comparison to his down payment.

This Court has recognized that the word "property" as used in the Internal Revenue Code, may, depending upon the circumstances of the case, comprise less than complete legal and equitable title. See *C. I. R. v. Moore* (C. A. 9), 207 F. 2d 265, at 268, column 2, where the Court said:

"But 'such property' is not the steel frame, brick and terra cotta loft and store building on the corner of Figueroa, Seventh and Flower Streets in the City of Los Angeles,—it is the taxpayer's interest in that property. And her interest is a limited one, not only because it is a fractional part, but also because it is subject to the lease . . ."

This Court has, as did the California court in *Moore's Estate*, *supra*, recognized the fact that a trust deed beneficiary has, under California law, a proprietary interest in real property which interest may be considered and determined in a condemnation action.

*Thibodo v. United States* (C. A. 9), 187 F. 2d 249, 256;

*Bullen v. De Bretteville* (C. A. 9), 239 F. 2d 824, 830.

Viewed in the light of these principles the separate properties of trustor (Respondent) and of the beneficiary were each, severally converted into money in the condemnation proceedings. Respondent received \$149,750.71 for his "property" and reinvested all of it in property similar or related in use or service and no gain should have been recognized. The decision of the Tax Court in this case was correct and should be affirmed.

**B. C. I. R. v. Fortee Properties, Inc. (C. A. 2), 211 F. 2d 915, cert. den. 348 U. S. 826, 75 S. Ct. 43, Was Wrongly Decided by the Second Circuit Court of Appeals.**

We think that the Second Circuit was in error in considering that the *Fortee* case was governed by *Commissioner v. Crane*, 331 U. S. 1.

All that was involved in *Crane* was a determination that, under the circumstances of the case, in order to arrive at the taxpayer's true capital gain, it was desirable to treat the principal of the unassumed mortgage as so much cash received on the sale. In substance the decision only amounts to saying that between the acquisition and sale of the property the taxpayer's capital account had increased in an amount equal to the depreciation taken by the taxpayer during her ownership plus the \$2,500.00 which she received at the time the property was sold.

The real question involved in such cases is: "What was the economic gain realized by the taxpayer?" This is illustrated by *Woodsam Associates Inc.*, 16 T. C. 649, aff'd 198 F. 2d 357, where an identical result is reached either by treating the mortgages as cash received or by



analyzing its capital account. The following tables show the two types of computation:

Commissioner's Computation

Mortgage in 1943		\$381,000.00
Less: Adjusted basis		
Original Cost	\$296,400.00	
Improvements	1,541.90	
Depreciation	(63,000.00)	234,941.90
		<hr/>
Gain		\$146,058.10

Analysis of Capital Account

Money derived from loans secured by the property during ownership	\$212,500.00
Less: Principal of loans repaid	26,500.00
	<hr/>
Net increase in cash position from loans	186,000.00
Return of cash down payment and cost of improvements	102,941.90
	<hr/>
Overall increase in cash position	83,058.10
Capital returned by way of allowance for depreciation	63,000.00
	<hr/>
Gain	\$146,058.10

Similarly in the case at bar the gain resulting from the conversion is the same whichever method is used.

(a) Sale Price, including trust deed balance, <i>arguendo</i> ,	\$207,323.34
Less: Adjusted Basis	
Original Cost	\$89,600.00
Depreciation	(8,000.00)
	<hr/>
Gain	\$125,723.34

(b) Cash received in condemnation	\$149,750.71
Less: Principal of purchase price paid	12,427.37
	<hr/>
	137,323.34
Return of cash down payment	19,600.00
	<hr/>
	117,723.34
Capital returned by way of depreciation allowance	8,000.00
	<hr/>
Gain	\$125,723.34

Thus in the case at bar we see that it is unnecessary to consider the unpaid balance of the trust deed as cash received in order to determine "the economic gain realized by the taxpayer." (*Woodsam, supra*, p. 655.)

Before analyzing the effect of *Internal Revenue Code*, Section 112(f)(2), upon the transaction in the case at bar it is well to point out that Section 111 relating to realization of gain and Section 112 do not always run hand in hand. In other words, if there is no gain under Section 111 as the result of an involuntary conversion, then it is immaterial how much cash was received or what was done with it. The mere fact, therefore, that it is convenient to include a mortgage debt as cash in the determination of gain does not require that the mortgage be regarded as cash for all purposes.

What is the real purpose of *Internal Revenue Code*, Section 112(f)(2)? It is to make sure, as a condition of non-recognition of gain, that a taxpayer's entire investment in the converted property, including his eco-

conomic gain, is transferred into property similar or related in service or use to the property converted. In the case at bar this result has been accomplished:

Down payment	\$ 19,600.00	
Principal payments	12,427.37	
	<hr/>	
	32,027.37	
Less: Capital returned by way of depreciation	8,000.00	Amount re-
	<hr/>	invested
	24,027.37	in similar
Gain	125,723.34	property
	<hr/>	<hr/>
Capital investment plus gain	\$149,750.71	\$149,750.71
	<hr/>	<hr/>

There can be cases, similar to *Woodsam, supra*, in which it would be necessary or desirable to treat the amount of a mortgage as cash received in order to arrive at a proper result. For instance, suppose that property fully paid for and having a market value of \$207,000.00 and an adjusted basis of \$82,000.00 has been mortgaged to secure payment of a cash loan of \$57,000.00 the proceeds of which have been received by the taxpayer. The property is then condemned, and \$207,000.00 paid, \$150,000.00 to the taxpayer and \$57,000.00 to the mortgagee. In such a case the entire capital investment and gain has not been reinvested if only the \$15,000.00 cash received from the condemnor is reinvested.

The same would be true if the mortgagor were personally liable and his assets were freed to the extent of \$57,000.00 by the payment of the mortgage in the condemnation proceedings.

In the case at bar the taxpayer was not personally liable for the balance unpaid under the trust deed.

*Cal. Code Civ. Proc.*, Secs. 580b and 580d.

Hence, no assets were freed by the payment of the trust deed balance in the condemnation proceedings, and no money or property or value was received by the taxpayer other than the sum of \$149,750.71, all of which was reinvested in similar property.

See: *Harper v. Heizer*, 103 Cal. App. 2d 388 at 390, in which appellant claimed that she had contributed value by signing a purchase money trust deed. *Held*: To the contrary; she suffered no detriment by executing the trust deed.

The whole purpose of *Internal Revenue Code* Section 112(f)(2) is to prevent the taxpayer from being required to pay a tax with respect to a capital gain which he has not sought, and may actively resent, which has been forced upon him by the irresistible power of a governmental agency, unless he chooses voluntarily not to re-establish his position. In cases such as *Fortee*, and the case at bar, the taxpayer cannot reinvest money that he does not and cannot receive.

In *Fortee*, the Second Circuit Court, to try to avoid the logic of the argument that since the taxpayer was not personally liable, no assets were freed by the satisfaction of the mortgage, and therefore no gain was realized, forced the issue by saying that as a practical matter

“ . . . the taxpayer-mortgagor has to treat the obligations of a non-assumed mortgage as if they were his personal obligations. Payment to the mortgagee relieved the owner of this necessity.”

This attempted justification was forced only because of a felt necessity to carry over into *Internal Revenue Code*, Section 112(f), a concept, useful but not necessary, used in determining the existence of a capital gain under *Internal Revenue Code*, Section 111.

On the side of the taxpayer, using the Second Circuit's approach, we might well force the issue the opposite way by saying as a practical matter that “. . . the taxpayer-mortgagor has to treat the money actually received by him in the condemnation proceeding as *all* of the money available for reinvestment.” In other words, how can a taxpayer invest money which he does not receive or control? And, is Section 112(f)(2) to be regarded as a device to add additional financial burdens upon property owners who have not fully paid for their properties while those who have fully paid, and who are financially better off, can avoid the impact of the tax entirely?

**C. The Tax Court's Decision Is Not Contrary to the Cases Cited by the Commissioner nor Is It Contrary to the Regulations and Interpretations of the Commissioner.**

In all of the cases cited by the Commissioner, except *Fortee*, distinguished above, the taxpayer actually received or had some control over the moneys which eventually were used for something other than reinvestment, or alternatively, by means of loans on the property while it was owned by him money were derived and spent for purposes other than reinvestment. We do not quarrel with the result in any of these cases except *Fortee*.

We think that it is this sort of thing that was contemplated by the Commissioner's regulations and inter-



pretations and not the situation in the case at bar for, as the Tax Court said [R. 12]:

“ . . . If his (the Commissioner's) regulation is intended to cover a case like this one in which the petitioner was not personally liable for the mortgages, then to that extent the regulation is invalid because it frustrates rather than promotes the intention of Congress.”

### Conclusion.

In conclusion, we see that the petitioner's several interest in real estate was converted into money, all of which was reinvested in similar property, and, in any event, the purpose for which *Internal Revenue Code* Section 112(f)(2) was enacted has been fully satisfied, regardless of which approach to the problem is used. The decision of the Tax Court in the case at bar was correct and should be affirmed.

Respectfully submitted,

AUSTIN CLAPP,

*Attorney for Respondent.*







## APPENDIX.

Internal Revenue Code of 1939:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

\* \* \* \* \*

(26 U. S. C. (1952 Ed.), Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

\* \* \* \* \*

(f) [as amended by Sec. 151(d) and (e) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Involuntary Conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat of imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or



in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain shall be recognized, but loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain).

\* \* \* \* \*

(26 U. S. C. (1952 Ed.), Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property*.—The basis of property shall be the cost of such property; except that—

\* \* \* \* \*

(26 U. S. C. (1952 Ed.), Sec. 113.)

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Section 580b, Code of Civil Procedure for the State of California, provides as follows:

“No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale or under a deed of trust, or mortgage, given to secure payment of the balance of the purchase price of real property.

“Where both a chattel mortgage and a deed of trust or mortgage have been given to secure payment of the balance of the combined purchase price of both real and personal property, no deficiency judgment shall lie at any time under any one thereof.”

Section 580d, Code of Civil Procedure for the State of California, provides in part as follows:

“No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property hereafter executed in any case in which the real property has been sold by the mortgagee or trustee under power of sale contained in such mortgage or deed of trust. \* \* \*”



No. 15889

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

NATIONAL LABOR RELATIONS BOARD,

*Petitioner,*

*vs.*

THE DEUTSCH COMPANY,

*Respondent.*

---

THE DEUTSCH COMPANY,

*Petitioner,*

*vs.*

NATIONAL LABOR RELATIONS BOARD,

*Respondent.*

---

On the Petition for Enforcement of an Order of the National Labor Relations Board and a Petition to Modify and to Set Aside Orders of the National Labor Relations Board.

---

## BRIEF FOR THE DEUTSCH COMPANY.

---

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FILED

CLERK OF COURT

PAUL T. O'BRIEN, CLERK





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### I.

Where the elected officials of the Union have abandoned their offices in the Union and non-elected officials of a separate Union have purportedly usurped the powers and functions of its said officers and are acting without any authority and without complying with the constitution and by-laws of the Union, and the Union for which they purport to act has never been certified as the exclusive bargaining agent for any of the "employer's" employees, then the said Union does not represent any of such employees and there is no existing Union which meets the description of the exclusive bargaining representatives of the "employer's" employees as set forth in the certification of representatives, and this honorable court should set aside the orders of the Board because the Board should have heard the entire of the testimony in regard to the said matter and upon the facts rejected in the complaint..... 28

## II.

Where, after a representation hearing, the National Labor Relations Board made its purported decision and direction of election, and purported to hold a certification election while the "employer's" petition for rehearing and reconsideration and stay of the election was pending before the Board, and before the Board made its order or gave notice of its order or ruling upon the said petition to the "employer" or its agents or attorneys, the purported election was held, the total number of those voting at the election equaling no more than forty per cent (40%) of the number of the eligible voters among the employees, the action of the Board in purporting to conduct an election and in purporting to issue a certification of representatives and in enforcing the said certification of representatives by bringing on for hearing the complaint herein was and is an abuse of its discretion, illegal and invalid, since the Board has violated its rules and regulations, the provisions of the National Labor Relations Act, the Administrative Procedure Act, and the Constitution of the United States in depriving the "employer" and its employees of due process of law ..... 34

## III.

A complaint alleging a violation of Section 8(a)(1) and (5) of the Act on the ground that "employer" refused to bargain with the Union as the exclusive representative of the employees in a unit for bargaining consisting of the production and maintenance employees at both of the plants, which unit is inappropriate for the purposes of collective bargaining within the meaning of Section 9(b) of the National Labor Relations Act, should be dismissed..... 38

- A. The only unit appropriate for purposes of collective bargaining, under Section 9(b) of the National Labor Relations Act, is the single plant unit, and a company unit is inappropriate, where the "employer" has two (2) plants which are geographically separated, which manufacture different products and sell the products separately out of separate sales departments and separate catalogs, which separate plants are in different cities, and are operated under separate autonomous plant managers, with the authority to hire and fire employees, each responsible only to the board of directors of the "employer's" corporation, where the separate plants have different working conditions and hours of work, where the skills employed in each of the separate plants are different from those employed in the other, the employees in one plant being mostly highly skilled machinists (the Avalon plant), and the employees in the other plant being unskilled assemblers and packagers (the Regent plant), where each plant has rates of pay different from the other, where the classification of the workers by sex is predominantly male at the Avalon plant, and almost entirely female at the Regent plant, where the "employer" has no uniform personnel policy for both of its plants, there being an incentive plan at the Avalon plant, and no incentive plan at the Regent plant, where there is no interchange of personnel between the plants nor uniform seniority list between the plants and where the majority of the production and maintenance employees at one plant, by secret ballot election, expressed their wish not to be represented by the Union (the Avalon plant), while it was and is believed, in good faith, by both the Union and the "employer" that a majority of the production and maintenance employees at the other plant (the Regent plant) did desire representation by the Union.. 38

- B. Where the "employer" has not refused to bargain with the Union on the basis of the unit appropriate for collective bargaining purposes under Section 9(b) of the National Labor Relations Act, a complaint alleging a violation of Sections 8(a)(1) and (5) for refusal to bargain will be dismissed..... 46

## IV.

The Board's purported decision and direction of election does not conclusively determine the issue of what is the appropriate unit for purposes of collective bargaining upon a complaint based on an alleged charge by the Union that the "employer" has violated Section 8(a), subsections (1) and (5), of the Act in refusing to bargain with the Union, where, since the representation hearing there has been either evidence newly discovered which would affect the determination of the appropriate unit or where, since the representation hearing, there has been a change of circumstances or where the finding of the Board as to the appropriate unit in its decision and direction of election and its conduct of the election was arbitrary and an abuse of its process.... 47

- A. A finding of the Board as to the appropriate unit is not conclusive and should be set aside where there is evidence newly discovered since the representation hearing that the "employer" and the Union agreed that a separate plant unit was the appropriate unit and to conduct a consent election wherein the employees voted on a single-plant basis in a secret ballot consent election conducted by the Union and the "employer" to determine whether they desired to be represented by the Union for purposes of collective bargaining and where, upon a vote of one hundred per cent (100%) of the eligible employees at the Avalon plant, a majority thereof voted against representation by the Union..... 47

- B. A finding of the Board as to the appropriate unit is not conclusive and should be set aside where there is a change of circumstances since the representation hearing that the "employer" and the Union agreed that a separate plant unit was the appropriate unit and to conduct a consent election wherein the employees voted on a single-plant basis in a secret ballot consent election conducted by the Union and the "employer" to determine whether they desired to be represented by the Union for the purposes of collective bargaining and where upon a vote of one hundred per cent (100%) of the eligible employees at the Avalon plant, a majority thereof voted against representation by the Union ..... 51
- C. A finding of the Board as to the appropriate unit is not conclusive and should be set aside where the Board acted arbitrarily and abused its processes in making its finding and its decision and direction of election based thereon, directing an election among the employees in a Company unit consisting of the production and maintenance employees in both of the plants, where there was not sufficient evidence at the representation hearing to support such a finding, and where such a finding and direction of election is contrary to the evidence upon the representation hearing and the law..... 53



## V.

Where the “employer” negotiated with the Union, and bargained with the Union, and after so doing, entered into an agreement in writing with the Union, which agreement was authorized by the Union’s membership, that the Union and the “employer” would conduct among the employees at one of the plants, a private consent election in accordance with the procedure and regulations of the National Labor Relations Board to determine whether these employees desired to be represented by the Union, and the said election was conducted pursuant to the terms of the said agreement, at which election all of the eligible employees at the said plant voted, and the results of the said election conclusively established that a majority of the employees did not desire to be represented by the Union, the Union is bound by the said agreement and the results of the said election that it would not continue to act as the collective bargaining representative of the said employees at the said plant, and the said agreement, and the said election, constitute bargaining between the “employer” and the Union, and are of full force and effect as determining the rights of the “employer,” the Union, and the employees, and the “employer” has bargained with the Union, as required by Section 8(a)(5) of the National Labor Relations Act, and has not interfered with, nor restrained, nor coerced its employees in the exercise of their rights guaranteed under Section 7 of the Act, nor has the “employer” violated Section 8(a)(1) of the Act, and the Union is estopped from contending that it is not bound by the said agreement and the results of said election or that the “employer” has violated Sections 8(a)(1) and 8(a)(5) of the National Labor Relations Act, or that any question “affecting commerce” exists concerning representation of the employees under Sections 9(c), 2(6) and 2(7) of the National Labor Relations Act ..... 56

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No. 15889  
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NATIONAL LABOR RELATIONS BOARD,

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THE DEUTSCH COMPANY,

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On the Petition for Enforcement of an Order of the National Labor Relations Board and a Petition to Modify and to Set Aside Orders of the National Labor Relations Board.

---

**BRIEF FOR THE DEUTSCH COMPANY.**

---

*To the Honorable Chief Justice of the United States Court of Appeals for the Ninth Circuit and the Associate Justices Thereof:*

Petitioner-respondent, The Deutsch Company, respectfully praying that the Petition of the National Labor Relations Board for Enforcement of its Order should be denied and the Petition of The Deutsch Company to Modify and Set Aside the Orders of the National Labor Relations Board should be granted, comes now and in support thereof respectfully submits:

## Statement of Proceedings and Jurisdiction.

This case is before this Honorable Court upon the Petition of the National Labor Relations Board for Enforcement of its Order [Tr. pp. 105-107], the Answer of Petitioner-Respondent The Deutsch Company to the said Petition for Enforcement [Tr. pp. 125-142], and upon the Petition of The Deutsch Company to Modify and Set Aside the Orders of the National Labor Relations Board [Tr. pp. 108-125].

Heretofore, the Board, after a hearing, issued its Decision and Direction of Election and Certification of Representatives and Orders in Representation Case No. 21-RC-4365 [Tr. pp. 211, 342-344, 253, 352, 333, 449-451; General Counsel's Exs. 2, 3, 4 and 8; Resp. Exs. 8 and 9]. Thereafter, a Complaint was filed in Case No. 21-CA-2581 by the Regional Director of the Twenty-First Region of the National Labor Relations Board, based upon an amended charge against the employer dated November 21, 1956, brought by the United Industrial Workers, Local 976, AIW-AFL-CIO, against The Deutsch Company alleging that the said Employer had been and was engaging in unfair labor practices within the meaning of Section 8(a), subsections (1) and (5) of the National Labor Relations Act. A hearing was conducted on January 14 and 15, 1957, in Los Angeles, California, before the Honorable Martin S. Bennett, Trial Examiner. The Trial Examiner thereafter gave his Intermediate Report and Recommended Order [Tr. pp. 29-79]. On February 19, 1957, the case was transferred to the National Labor Relations Board by an Order transferring the case, and, on September 4, 1957,

the Board issued its Decision and Order in the matter [Tr. pp. 80-85].

The jurisdiction of the Board arises because the Employer is engaging in interstate commerce in the manufacture of aircraft parts and components and screw machine products.

This Honorable Court has jurisdiction to review said Orders by reason of the Petitions of the National Labor Relations Board and The Deutsch Company under Section 10, subsections (e) and (f) of the National Labor Relations Act as amended, 29 U. S. C. A. 160(e) and (f).

### **Statement of Facts.**

#### **1. Description of Employer's Plants and Employees.**

The Deutsch Company (sometimes hereinafter referred to as "Employer") is a manufacturing corporation organized and incorporated under and pursuant to the laws of the State of California. Since 1954, it has operated two (2) plants, the main manufacturing plant, which also contains assembly and shipping facilities, at 7000 South Avalon Boulevard (sometimes hereinafter referred to as the "Avalon Plant"), and an assembly and shipping and receiving plant for specific Army-Navy fittings and electric couplings at 6345 Regent Street, Huntington Park, California (sometimes hereinafter referred to as the "Regent Plant") [Tr. pp. 164-165].

The Avalon Plant is a machine shop operation; the majority of the Avalon employees are highly skilled machine operators; even the Avalon assemblers are semi-skilled operators, who are capable of doing and do a substantial amount of work on drill presses [Tr. pp.

311-313]. The Regent employees are unskilled assemblers and packagers, none of whom, for example, are qualified to do, nor do they work on drill presses [Tr. pp. 313-314].

There is a substantial and significant difference between the items produced by each of the Plants [Tr. p. 165]. The Avalon Plant manufactures and assembles valves, rivets and various screw machine products [Tr. p. 311]. The Regent Plant, however, does no manufacturing; it is involved only with assembling a limited class of Army and Navy electronic and aircraft components [Tr. pp. 176, 311]. The type of assembly work is substantially different, involving different skills and working conditions.

Each plant has its own sales department, its own sales catalogs, and its own packaging and shipping and receiving departments [Tr. pp. 168-169, 317].

Each plant has its own separate and autonomous manager and supervisor, Mr. Philip Holzman at Avalon and Mr. Edward Jones at Regent [Tr. pp. 171-172, 315-316].

There are twenty-two (22) general job classifications at the Avalon Plant, whereas there are only four (4) at the Regent Plant. The four (4) at the Regent Plant, are duplicated in name only at the Avalon Plant. There is no identity or duplication in the type of work done or in the product worked upon. The four (4) job classifications which use the same names at each Plant are: assembler, packager, shipping and receiving clerk, and production and control clerk [Tr. pp. 311-313].

Regent Street receives eight and one-third per cent (8 and  $\frac{1}{3}\%$ ) of the output of the Avalon Plant for its

material components requirements for assembly functions [Tr. p. 311].

The Avalon Plant at present has approximately three hundred seventy-five (375) employees, while the Regent Plant has eighty-five (85) employees. Two-thirds ( $\frac{2}{3}$ ) of the Avalon Plant employees are male, and one-third ( $\frac{1}{3}$ ) female; at the Regent Plant, seven-eighths ( $\frac{7}{8}$ ) of the employees are female, and one-eighth ( $\frac{1}{8}$ ) male [Tr. p. 313].

The Avalon Plant works on two (2) shifts, with different shift hours for male and female employees and different rest periods for male and female employees. The Regent Plant, however, works only one (1) shift. The Avalon Plant regularly schedules overtime work on Saturday every other week. Thus, its working schedule alternates between a five (5) day week and a six (6) day week. The Regent Plant very seldom, and then only irregularly, schedules any overtime work [Tr. pp. 165, 313-315].

There is no uniform personnel policy with respect to the two (2) plants. For example, incentive pay is awarded at the Avalon Plant, but not at the Regent Plant. There is no interchange of personnel between the Plants, nor any practice of giving seniority to the employees of both plants on one seniority list. Moreover, rates of pay are different because the employees perform different tasks [Tr. p. 315].

A majority of the "Employer's" production and maintenance employees at its Avalon Plant do not desire to be represented by the Union for the purposes of col-



lective bargaining, while a majority of the production and maintenance employees at Regent did favor representation by the Union [Tr. pp. 247, 315].

**2. Chronology of Events With Regard to Representation and Collective Bargaining at "Employer's" Plants.**

Commencing with May of 1955, the United Industrial Workers Local 976, AIW-AFL-CIO, as it was then named (sometimes hereinafter referred to as the "Union"), conducted an organizational drive at "Employer's" plants.

On March 28, 1956, the Union filed a Petition for Certification of Representatives, in Case No. 21-RC-4365. The Petition alleged as the address of the "Employer" only the Avalon Plant address [Tr. p. 162].

Representation hearings in the said Representation Case were held on May 8, 10, 11 and 17, 1956. Upon the Representation Hearings:

(a) The International Association of Machinists, District 94, AFL-CIO, and the International Union, United Automobile, Aircraft and Agricultural Implement Workers of America, UAW-AFL-CIO were intervenors [Tr. pp. 160-162];

(b) Some evidence as to the appropriate unit for collective bargaining was introduced, but the Petitioning Union, the United Industrial Workers, did offer to stipulate on all of the evidence presented at the Representation Hearing that the unit of "Employer's" employees appropriate for the purposes of collective bargaining within the meaning of Section 9(b) of the Act is the separate plant unit, which stipulation was and is acceptable to the "Employer" [Tr. pp. 189-195];

(c) There was no evidence introduced as to (nor was there any way at that time of obtaining the evidence without a self-determination election) of the sentiment of the “Employer’s” employees at each of the “Employer’s” plants to determine their desire with reference to being represented for collective bargaining purposes by a Union.

In spite of the lack of any evidence upon the Representation Hearing to support a finding that the appropriate unit of “Employer’s” employees for the purposes of collective bargaining was the entire company unit, and, notwithstanding the stipulations acceptable to the Union and the “Employer”, the Board, on or about July 9, 1956, made its purported Decision and Direction of Election in Case No. 21-RC-4365, wherein it directed that an election be conducted in the Company unit. The Board did, however, find [General Counsel’s Ex. 2] that a separate unit at each of “Employer’s” plants would be appropriate for the purposes of collective bargaining, as well as the Company unit, consisting of both plants [Tr. pp. 211, 338-341].

On or about July 24, 1956, “Employer” filed with the National Labor Relations Board its Petition for: (1) Rehearing and Reconsideration by the Board of its Decision and Direction of Election, and (2) an Order suspending election pending determination of the Petition and further decision and order of the Board; and (3) an Order authorizing and permitting Petitioner to offer and submit new and additional evidence; and (4) an Order vacating previous Decision and Direction of Election; and (5) an Order dismissing the Petition of the Union for certification [Resp. Ex. 6; Tr. pp. 320, 424-446].

On or about August 8, 1956, the Regional Office of the Board purported to hold an election. Neither the "Employer" nor its Labor Relations Consultants, nor its attorneys, had received any notice in any manner whatsoever from the Board as to its decision on the said Petition of the "Employer" then pending before the Board [Tr. pp. 326-330].

The purported Election was held on August 8, 1956, over the objections of the "Employer." There was no employees' list of "Employer's" employees in the hands of the persons purporting to conduct the election, nor was the election held on the Plant premises. Less than forty per cent (40%) of the "Employer's" employees eligible to vote cast ballots at that election [Tr. pp. 248-249].

On August 10, 1956, the Board by telegram notified the "Employer", by notifying its Labor Relations Consultant and its Attorneys, of its ruling upon the "Employer's" said Petition, by stating that the said Petition "is hereby denied" [Resp. Exs. 8 and 9; Tr. pp. 251-254, 333, 449-451].

On August 20, 1956, the Board purported to issue a Certification of Representatives, which certified the United Industrial Workers, Local 976, AIW-AFL-CIO, as the representative of the "Employer's" employees in the Company Unit for the purposes of collective bargaining [General Counsel's Ex. 3; Tr. pp. 211, 342-343]. This Order was purportedly amended on October 29, 1956, to change the name of "United Industrial Workers" [General Counsel's Ex. 4; Tr. pp. 211, 343-344].

On September 14, 1956, Anthony Doria, the Secretary-Treasurer of the Union, wrote a letter to the "Employer" requesting arrangements for negotiations between the Union and the "Employer." A copy of the letter was sent to H. DeVoe Rea & Associates, the Labor Relations Consultants of the "Employer," the retaining of which firm as consultants, as appears on the face of the letter [General Counsel's Ex. 5; Tr. pp. 345-347] was known to the Union. Thereafter, Mr. Thomas Aiken of the office of H. DeVoe Rea & Associates, telephoned Mr. Doria, and a meeting was arranged [Tr. p. 274].

On September 24, 1956, the "Employer" sent to the Union a telegram advising that any meetings should be arranged with H. DeVoe Rea & Associates, its Labor Relations Representatives [Resp. Ex. 3; Tr. p. 375].

A meeting was held on September 26, 1956, between H. DeVoe Rea and Thomas Aiken, representing the "Employer", and Anthony Doria, representing the Union, in the offices of H. DeVoe Rea. At that time, the "Employer" bargained with the Union on various subjects which might be provisions in an Agreement between them [Tr. pp. 275-277]. Some of these subjects of bargaining were set forth in a memo by Mr. Doria in his own handwriting and given to Mr. Rea [Resp. Ex. 1; Tr. pp. 277, 372-373].

Thereafter, Mr. Doria left the city for approximately two (2) weeks. In the interim, two (2) of the business agents of the Union at a chance meeting had a discussion with Mr. Philip Holzman, the manager of the Avalon Plant, suggesting that a consent election be held at the Avalon Plant to determine whether a majority of the

employees at the Avalon Plant desired to be represented by the Union. Both the business agents and Mr. Holzman agreed to go back to their principals for further discussion of the proposal by the business agents [Tr. pp. 303-305].

During the latter part of October and early November, 1956, Mr. Thomas Aiken had telephone discussions with Mr. Doria with regard to the Union's proposal that a consent election be conducted by the Respondent and the Union at the Avalon Plant [Tr. pp. 277-282].

On October 2, 1956, the Union filed an Unfair Labor Charge against the Company, alleging violations of Section 8(a)(1), (3) and (5) of the Act. On November 1, 1956, the Company wrote to the Board denying the truth of any allegation in the charge of October 2, 1956. No Complaint was ever issued on that charge.

On November 11, 1956, the majority of the Union members at its meeting authorized the Union to enter into an agreement for the conducting of a consent election at the Avalon Plant by the Union and the Company [Tr. pp. 337, 368-372].

On November 12, 1956, a meeting was held at the offices of H. DeVoe Rea, at which there were present: Anthony Doria, the Secretary-Treasurer of the Union and Peter Lentini, the Business Agent of the International with which the Union is affiliated, and the President of the Union, and Mr. Thomas Aiken of H. DeVoe Rea & Associates, and Mr. Philip E. Holzman, the General Manager of the Avalon Plant, and Mr. Edward Jones, the General Manager of the Regent Plant. After extensive negotiations and bargaining between the Union and the



“Employer”, a written agreement was entered into [Resp. Ex. 4; Tr. pp. 375-377], whereby the Union agreed with the Company as follows: That a consent election would be conducted by the Union and the “Employer” on Friday, November 16, 1956, at the Avalon Plant, in order to establish whether the Union represented a majority of the production and maintenance employees at the Avalon Plant; the payroll date of July 8, 1956, would be used in the election to determine eligibility of employee voters (This was the same payroll date as was used in the Board-Conducted election in August); production and maintenance employees would be those fitting the description in the Board’s purported Decision and Direction of Election; observers of the conduct of the election and the manner of challenging of ballots were agreed upon; if the majority of the employees voting, voted for the Union, then the “Employer” would immediately enter into further bargaining negotiations with the Union for the Avalon Plant on such additional subjects as to which bargaining was desired by the Union; the “Employer” would continue to bargain with the Union with regard to the Regent Plant, regardless of the outcome of the election; if a majority of the employees voting, voted against representation by the Union, the Union would refrain from any type of harassing action against the “Employer,” including any work stoppage or interference of any kind with production; by direct implication, the Union recognized that the appropriate unit of “Employer’s” employees for collective bargaining was and is the separate plant unit, and the Union would accept the desires of the majority of the employees at the Avalon Plant as evidenced by the results obtained upon the con-

sent election to determine whether or not the Union would represent the employees at the Avalon Plant; the Union waived and abandoned its rights, if any under the purported Decision and Direction of Election and the purported Election of August 8, 1956, to bargain for the employees of "Employer" at its Avalon Plant [Tr. pp. 238-240, 306, 322-324].

The Consent Election was held on November 16, 1956 and one hundred sixty-nine (169) votes were cast for no Union representation, while only one hundred thirty-seven (137) votes voted for the Union [Tr. p. 247].

On November 21, 1956, the Union filed with the Board its Charge, which alleged a violation by the "Employer" of Sections 8(a), (1) and (5) of the Act. The Union did not advise the Regional Director or any of his staff that the Union and Respondent had entered into the written agreement of November 12, 1956, or that a Consent Election had been held or what the results of the election were [Tr. pp. 250-251].

On December 4, 1956, the "Employer", by Thomas Aiken of its Labor Relations Consultants, had a meeting lasting approximately four (4) hours, with Anthony Doria, Peter Lentini, Dorothea Powell, David Castro and Benny Benedetto. At that meeting, the "Employer" bargained with the Union on the terms of a proposed Collective Bargaining Agreement. Each of the items in a Collective Bargaining Agreement form were discussed. Mr. Aiken, on behalf of Respondent at the time of the meeting made notes of the discussion on his copy. [Resp. Ex. 5; Tr. pp. 284-286, 378-424].

On December 5, 1956, the General Counsel issued, on behalf of the Board, his Complaint in this case, based

upon the alleged violations in the Charge of November 21, 1956 [Tr. pp. 7-11].

On December 14, 1956, Mr. Doria and Mr. Aiken had a telephone conversation, discussing the meeting of December 4, 1956. At that time, Mr. Doria admitted that the form of Collective Bargaining Agreement which he had proposed at the December 4th meeting was extreme, and that his proposals for the Regent Street Plant involved a Union shop, a check-off, and an increase in wage rates in the amount of approximately twelve cents (12¢) an hour. Mr. Aiken requested that Mr. Doria put his proposals in writing, and Mr. Doria agreed that he would. He has not ever done so [Tr. pp. 288-289].

### 3. "Employer's" Offer of Stipulation.

The "Employer" throughout these proceedings offered to stipulate and agree to a consent order whereby the purported Decision and Direction of Election and the Certification of Representatives on which it was based would be withdrawn, the unit of "Employer's" employees appropriate for the purposes of collective bargaining would be the single plant unit, with one unit consisting of the Avalon Plant and one unit consisting of the Regent Plant, a self-determination election would be held at "Employer's Avalon Plant, under the auspices of, and conducted by, the Board to determine whether or not the production and maintenance employees at the Avalon Plant, as defined in the said Decision and Direction of Election, desired to be represented by the Union. For this purpose, the "Employer" is willing to concede that a majority of the production and maintenance employees at the "Employer's" Regent Plant did favor representation by the Union [Tr. pp. 208-210].

**4. Facts Concerning Schism Within the Union and Basis for Review of Board Certification of Representatives and Decision and Direction of License Herein.**

From May of 1955 until September, 1957, the officers of the Union consisted of one Nick Nardi as the President, and, in turn, Anthony Doria, Bradley Smiler and Peter Lentini, as Secretary and Treasurer thereof.

On or about September 6, 1957, the said Union, United Industrial Workers, Local 976, OIW-AFL-CIO, by its Secretary, Peter Lentini, sent a letter to The Deutsch Company requesting notification of a date, time and place when negotiations might be conducted on a proposed agreement.

Thereafter certain persons, including Carl W. Griepentrog, Frank Evans and Bert Backinger, claiming to be, respectively, the President, an Executive Board Member, and a Vice President of the International Union, Allied Industrial Workers of America, affiliated with AFL-CIO, called upon The Deutsch Company and its representatives and claimed to be the persons who are entitled to bargain with The Deutsch Company in connection with and as agent and exclusive representative of The Deutsch Company's employees for the purpose of collective bargaining. Insofar as The Deutsch Company has been informed, neither Carl W. Griepentrog, nor Frank Evans, nor Bert Backinger were or are elected officials of United Industrial Workers, Local 976, AIW-AFL-CIO, but they have usurped the powers of the officials of the said Union and they are acting without any authority of the said Union and without complying with the Constitution or the By-Laws of the said Union. The Allied Industrial Workers

of America, for which the said Griepentrog, Evans and Backinger claimed to be spokesman, is not, and never has been certified as the exclusive representative of any of the employees of The Deutsch Company. The said Union does not represent any of the employees of The Deutsch Company.

All of the officers of the Union which purported to be certified, including Anthony Doria, Peter Lentini, Nick Nardi and Bradley Smiler, have abandoned and discontinued their offices and said Union has either been dissolved or they have formed another and separate Union, as The Deutsch Company has been informed and believes.

By reason of the foregoing, there is no existing union which meets the description of the exclusive bargaining representative of The Deutsch Company's employees as set forth in the Certification of Representatives in this case. There is, therefore, no existing union which is certified as the exclusive bargaining representative for the employees of The Deutsch Company.

The Deutsch Company has received conflicting demands from certain persons consisting of said Peter Lentini and others, on the one, had to negotiate with them, alleging that they are officers of United Industrial Workers, Local 976 AIW-AFL-CIO, and from Evans and Backinger, on the other hand, purporting to be officers of the Allied Industrial Workers of America, affiliated with the AFL-CIO, alleging that negotiations must be conducted with them. There is apparently a conflict, and it is the belief of The Deutsch Company that neither of the groups involved is authorized to represent the employees



of The Deutsch Company as the exclusive representatives for purposes of collective bargaining under the said certification of representatives or otherwise.

All of the foregoing was brought to the attention of the National Labor Relations Board by the Motion of The Deutsch Company for: (1) Rehearing and Reconsideration by the Board of its Decision and Order; and (2) an Order Setting Aside Previous Decision and Direction of Election; and (3) an Order Setting Aside the Previous Certification of Representatives and Amendment Thereto [Tr. pp. 86-101].

On November 7, 1957, the Motion of The Deutsch Company was denied [Tr. pp. 103-104].

### **Specification of Errors.**

#### **I.**

An implied ruling that where the elective officers of the Union have abandoned their offices in the Union and non-elected officials of a separate Union have purportedly usurped the powers and functions of the said officers and are acting without having authority and without complying with the Constitution and By-Laws of the Union, and the Union for which they purport to act has never been certified as the exclusive bargaining agent of any of the "Employer's" employees, the said Union represents such employees and there is an existing Union which meets the description of the exclusive bargaining representatives of "Employer's" employees as set forth in the Certification of Representatives.

That the National Relations Labor Board has abused its discretion and acted contrary to the National Labor Relations Act and the United States Constitution in re-

fusing to hold a hearing and take testimony on the facts thereof and in denying summarily “Employer’s” Motion for (1) Rehearing and Reconsideration; and (2) an Order Setting Aside the Decision and Direction of Election; and (3) an Order Setting Aside the Certification of Representatives.

Citation of Record: Tr. pp. 86-101; 103-104.

## II.

The Board’s Conclusions and Findings that the conducting of an election among “Employer’s” employees by the National Labor Relations Board adjacent to the premises of the “Employer’s” plant, but without either a list of the employees qualified to vote, and without any notice to the “Employer” or its employees that the election was being conducted, and at which election only a number of ballots equal to forty per cent (40%) of the number of employees eligible to vote were cast, and which election was conducted pending the hearing upon and prior to the Board’s ruling and notice of its ruling to Employer upon its Petition for Rehearing and Reconsideration by the Board of its Decision and Direction of Election and for an Order Suspending the Election pending the determination of the Petition and for an Order authorizing and permitting the “Employer” to offer new and additional evidence, and for an Order vacating the previous Decision and Direction of Election, and for an Order Dismissing the Union’s Petition for Certification, was a valid election binding upon the “Employer” and was a valid basis for the issuance of a Certificate of Representatives under the National Labor Relations Act.

This Finding or Conclusion is unsupported by any evidence in the record, is based upon the speculation of the Trial Examiner, is contrary to the National Labor Relations Act, the Rules and Regulations of the National Labor Relations Board and the Administrative Procedure Act, and the United States Constitution, and would deprive the Union and the "Employer" and the employees of their right to a fair hearing and a proper determination of the appropriate collective bargaining unit and a fair election to determine the desires of the employees as to their collective bargaining agent.

The recommendations based on this Improper Finding or Conclusion are contrary to the National Labor Relations Act and the Administrative Procedure Act and the Rules and Regulations of the National Labor Relations Board.

The Finding or Conclusion resulted in part from certain improper Rulings of the Trial Examiner upon certain of "Employer's" motions and objections, which permitted improper and incompetent testimony and evidence, speculations and conclusions of witnesses, testimony in violation of the parol evidence rule, immaterial and irrelevant testimony and documents, self-serving testimony and documents, hearsay evidence, and were contrary to law and the evidence.

Citation of the Record:

*Intermediate Report and Recommended Order:*

Tr. pp. 35-39, 52-55, 60-64, 69, 75-85.

*Transcript of Proceedings Before the Trial Examiner:*

Tr. pp. 208, 210-211, 249-250, 252-253, 272-273, 296-297, 330.

### III.

The Board's Conclusions and Findings that where, upon Representation Proceedings at the conclusion of which the National Labor Relations Board issued its Decision and Direction of Election which found, among other things, that a separate unit at each of "Employer's" plants could be appropriate for the purposes of collective bargaining, and thereafter certified the Union as the representative for a single unit of the production and maintenance employees consisting of both of "Employer's" plants as appropriate, although no evidence was introduced at the representation proceedings or was available or was able to be obtained with the exercise of due diligence by the "Employer" or the Union that, subsequent to the Certification of Representatives, the "Employer" and the Union agreed in writing that the "Employer" and the Union would conduct a private consent election at one of "Employer's" plants to determine whether the employees in that Plant desired to be represented by the Union and the said election was conducted in accordance with the procedures of the National Labor Relations Board, although it was not conducted by the Board, and at such election all the employees at said plant eligible to vote voted and a majority thereof voted against representation by the Union, the said Agreement in writing, the said election, and the results of the said election, are not evidence newly discovered, and were available to the "Employer" and were obtainable at the time of the Representation Hearing with the exercise of due diligence, which, if presented to the Board, would not have caused said Board to find that a separate unit at each of the said plants was the appropriate

unit for the purposes of collective bargaining, and were not a change of circumstances that would have caused said Board to find that a separate unit at each of said plants was the appropriate unit for the purposes of collective bargaining, and the issuance of its Decision and Direction of Election, and the conducting of its election pending its determination of "Employer's" Petition for Reconsideration by the Board and the issuance of its Certification of Representatives was not an arbitrary act of the Board and an abuse of the Board's discretion.

This Finding or Conclusion is unsupported by any evidence in the record, is based upon the speculation of the Trial Examiner, is contrary to the National Labor Relations Act, the Rules and Regulations of the National Labor Relations Board and the Administrative Procedure Act and the United States Constitution, and would deprive the Union and the "Employer" of their right to reach an agreement reduced to writing with the ultimate purpose of composing their differences, and to a fair hearing and a proper determination of the appropriate collective bargaining unit and a fair election to determine the desires of the employees as to their collective bargaining agent.

The Recommendations based on this improper Finding or Conclusion are contrary to the National Labor Relations Act and the Administrative Procedure Act and the Rules and Regulations of the National Labor Relations Board.

The Finding or Conclusion resulted in part from certain improper Rulings of the Trial Examiner upon certain of "Employer's" motions and objections, which permitted



improper and incompetent testimony and evidence, speculations and conclusions of witnesses, testimony in violation of the parol evidence rule, immaterial and irrelevant testimony and documents, self-serving testimony and documents, hearsay evidence, and were contrary to law and the evidence.

*Intermediate Report and Recommended Order:*

Tr. pp. 56-59, 68-69, 75-85.

*Transcript of Proceedings Before the Trial Examiner:*

Tr. pp. 205, 207-208, 243-244, 248-249, 272-273, 287, 294-295, 297-298, 310-311, 319-320.

IV.

The Board's Conclusion and Finding that the Union certified by the National Labor Relations Board as the representative of "Employer's" employees for purposes of collective bargaining did not have the authority, although it was given and authorized by the Union membership, to enter into, with "Employer," an Agreement in writing that the Union and "Employer" would conduct among "Employer's" employees, at one of its plants, a private consent election in accordance with the procedure and regulations of the National Labor Relations Board to determine whether those employees desired to be represented by the Union.

This Finding or Conclusion is unsupported by any evidence in the record, is based upon the speculation of the Trial Examiner, is contrary to the National Labor Relations Act and the United States Constitution, and would deprive the Union and the "Employer" of their right to reach an agreement reduced to writing with the ultimate purpose of composing their differences.

The Recommendations based on this improper Finding or Conclusion are contrary to the National Labor Relations Act.

The Finding or Conclusion resulted, in part, from certain improper Rulings of the Trial Examiner upon certain of "Employer's" motions and objections, which permitted improper and incompetent testimony and evidence, speculations and conclusions of witnesses, testimony in violation of the parol evidence rule, immaterial and irrelevant testimony and documents, self-serving testimony and documents, hearsay evidence, and were contrary to law and the evidence.

*Intermediate Report and Recommended Order:*

Tr. pp. 46-53, 65-67, 69-74, 76-85.

*Proceedings Before the Trial Examiner:*

Tr. pp. 258-260, 265, 272-273, 297-299, 325, 328-329, 335-337.

V.

The Board's Conclusion and Finding that where the Union, after authorization from Union's membership so to do, entered into an Agreement in writing with the "Employer" that the Union and the "Employer" would conduct among its employees, at one of its plants, a private consent election in accordance with the procedure and regulations of the National Labor Relations Board to determine whether those employees desired to be represented by the Union, and the said election was conducted pursuant to said Agreement, at which all of the eligible employees at the said plant voted, and the results of the said election conclusively established that a majority of

the employees did not desire to be represented by the Union, the Union is not estopped from contending that it is not bound by the said Agreement and the results of the said election.

This Finding or Conclusion is unsupported by any evidence in the record, is based upon the speculation of the Trial Examiner, is contrary to the National Labor Relations Act and the United States Constitution, and would deprive the Union and the "Employer" of their right to reach an agreement reduced to writing with the ultimate purpose of composing their differences.

The Recommendations based on this improper Finding or Conclusion are contrary to the National Labor Relations Act.

The Finding or Conclusion resulted in part, from certain improper Rulings of the Trial Examiner upon certain of "Employer's" motions and objections, which permitted improper and incompetent testimony and evidence, speculations and conclusions of witnesses, testimony in violation of the parol evidence rule, immaterial and irrelevant testimony and documents, self-serving testimony and documents, hearsay evidence, and were contrary to law and the evidence.

Citation of the Record:

*Intermediate Report and Recommended Order:*

Tr. pp. 49-50, 53-54, 64-67, 71-72, 75-85.

*Proceeding Before the Trial Examiner:*

Tr. pp. 258-259, 272-273, 297-299, 310-311, 325, 328, 334-337.

## VI.

The Board's conclusion and finding that negotiations by Employer with the Union with regard to matters of representation, and which negotiations resulted in an Agreement in writing between the Union and the "Employer," which Agreement was fully performed by the "Employer," was not bargaining by the "Employer" as required by Section 8(a)(5) of the National Labor Relations Act, and was interference with and restraining and coercing the employees in the exercising of their rights guaranteed under Section 7, as provided by Section 8(a)-(1) of the National Labor Relations Act.

This Finding or Conclusion is unsupported by any evidence in the Record, is based upon the speculation of the Trial Examiner, is contrary to the National Labor Relations Act and the United States Constitution, and would deprive the Union and the "Employer" of their right to reach an agreement reduced to writing with the ultimate purpose of composing their differences.

The Recommendations based on this improper Finding or Conclusion are contrary to the National Labor Relations Act.

The Finding or Conclusion resulted in part from certain improper Rulings of the Trial Examiner upon certain of "Employer's" motions and objections, which permitted improper and incompletent testimony and evidence, speculations and conclusions of witnesses, testimony in violation of the parol evidence rule, immaterial and irrelevant testimony and documents, self-serving testimony and documents, hearsay evidence, and were contrary to law and the evidence.

Citation of the Record:

*Intermediate Report and Recommended Order:*

Tr. pp. 39-55, 64-85.

*Transcript of Proceedings Before the Trial Examiner:*

Tr. pp. 254-260, 261-262, 272-273, 287, 292, 294-295, 296-299, 303, 325, 328-329, 335-337.

## VII.

The Board's Conclusions and Findings that where, upon a representation proceeding, the National Labor Relations Board issued its Decision and Direction of Election finding that an appropriate unit for purposes of collective bargaining could be the separate unit at each of "Employer's" two plants, but, however, the Union was certified as the representative of the employees in a single two-plant unit, and thereafter, the Union and the "Employer" entered into an Agreement in writing that the Union and "Employer" would conduct a private consent election in accordance with the procedure and regulations of the National Labor Relations Board, and where, upon such election, in accordance with procedure of the National Labor Relations Board, all of the eligible employees voted, and a majority thereof voted against representation by the Union, such agreement and such election did not arise out of and do not constitute bargaining between the "Employer" and the Union, and were and are of no force and effect.

This Finding or Conclusion is unsupported by any evidence in the record, is based upon the speculation of the Trial Examiner, is contrary to the National Labor Relations Act and the United States Constitution, and would deprive the Union and the "Employer" of their



right to reach an agreement reduced to writing with the ultimate purpose of composing their differences.

The Recommendations based on this improper Finding or Conclusion are contrary to the National Labor Relations Act.

The Finding or Conclusion resulted in part from certain improper Rulings of the Trial Examiner upon certain of "Employer's" motions and objections, which permitted improper and incompetent testimony and evidence, speculations and conclusions of witnesses, testimony in violation of the parol evidence rule, immaterial and irrelevant testimony and documents, self-serving testimony and documents, hearsay evidence, and were contrary to law and the evidence.

Citation of the Record:

*Intermediate Report and Recommended Order:*

Tr. pp. 49-54, 64-67, 68-69, 75-85.

*Transcript of Proceedings Before the Trial Examiner:*

Tr. pp. 258-259, 272-273, 297-300, 310-311, 325, 328-329, 335-337.

### Summary of Argument.

The essence of the case is that the employees of The Deutsch Company have been deprived of their right to choose their collective bargaining representative. The agents of the National Labor Relations Board seem bound to force the employees of The Deutsch Company against their desires to accept first one Union and then another to represent them. The first time this was attempted such confusion resulted that no valid election was ever held by the Board. Despite the fact that the

Union and the "Employer" sought to rectify this error by a consent election, the Board refused to recognize the results of the consent election between the parties or to order a new election which it might conduct and which would not be tainted with administrative error. Finally when an interunion dispute broke out and a schism resulted, the Board summarily, without a hearing, sought to enforce the Trial Examiner's previous ruling.

Throughout there has been a failure of the Board properly to determine an appropriate unit for the purposes of collective bargaining.

The Board's orders were not only contrary to the law and to the policy of the Board, but also deprived the employees of The Deutsch Company of the right to choose their own bargaining representative.

For these reasons the Petition of the Board should be denied and the Petition of The Deutsch Company should be granted.

## ARGUMENT.

### I.

Where the Elected Officials of the Union Have Abandoned Their Offices in the Union and Non-elected Officials of a Separate Union Have Purportedly Usurped the Powers and Functions of Its Said Officers and Are Acting Without Any Authority and Without Complying With the Constitution and By-Laws of the Union, and the Union for Which They Purport to Act Has Never Been Certified as the Exclusive Bargaining Agent for Any of the "Employer's" Employees, Then the Said Union Does Not Represent Any of Such Employees and There Is No Existing Union Which Meets the Description of the Exclusive Bargaining Representative of the "Employer's" Employees as Set Forth in the Certification of Representatives, and This Honorable Court Should Set Aside the Orders of the Board Because the Board Should Have Heard the Entire of the Testimony in Regard to the Said Matter and Upon the Facts Rejected in the Complaint.

Subsequent to the determination by the National Labor Relations Board of its decision in Case No. 21-CA-2581, a schism occurred in the Union. The officers and leading members of the Union consisting of Nick Nardi, Anthony Doria, Bradley Smiler, and Peter Lentini were suddenly ousted. Mr. Doria's activities had been called into question. Disputes arose as to the authority of various persons to represent the employees of The Deutsch Company [Tr. pp. 97-101].

The telegram of the attorneys for the Union shows the confusion in stating that an injunction had been issued

by the Los Angeles Superior Court on September 20, 1957 in Case No. 686,697 entitled *Carl W. Griepentrog, as President, AIW-AFL-CIO v. Peter Lentini and Nick Nardi, et al.*, restraining the former officers of Local 976 from acting or purporting to act in any official capacity for or in behalf of Local 976 and from notifying or advising the company that they have authority to conduct the business or affairs of Local 976 and further restraining them from interfering in any manner whatsoever with Carl W. Griepentrog, or any authorized representative of the plaintiff, as international president of the Allied Industrial Workers of America, AFL-CIO or such international union from conducting, managing or controlling the affairs of Local 976 [Tr. pp. 102-103].

Although the Board has denied there was a dissolution or schism within Local 976, the facts were never investigated by the Board. It does appear from the said telegram which appears in the transcript [Tr. pp. 101-103] and it is alleged by the "Employer" [Tr. pp. 97-100], that certain persons, including Carl W. Griepentrog, Frank Evans and Bert Backinger, purporting to be officers and board members of the Allied Industrial Workers of America, affiliated with AFL-CIO have called upon The Deutsch Company and its representatives and claimed to be the persons entitled to bargain with The Deutsch Company as the agent and exclusive representative of The Deutsch Company's employees for the purpose of collective bargaining. However there are no facts nor are there any allegations by the Board to support the fact that Carl W. Griepentrog, Frank Evans, or Bert Backinger were elected officials of United Industrial Workers,

Local 976, AIW-AFL-CIO. It appears, therefore, that they have usurped the powers and functions of the officials of the said Local 976 and are acting without any authority.

The Certification of Representatives never listed the Allied Industrial Workers Union of America, AFL-CIO, as the representative for the purpose of collective bargaining of The Deutsch Company's employees [Tr. pp. 242-344].

The Board and the Union seek to accomplish indirectly through these men what cannot be done under the Act, that is, an Amendment to the Certification of Representatives without a hearing and a representation election.

Before such an Act can be accomplished, it is necessary that the employees to be represented be heard. The procedure of accomplishing this is through a petition and a secret ballot of the employees.

*Weatherhead Company of Antwerp*, 106 N. L. R. B. 1266 (1953);

*R. M. Hollingshead Corporation*, 111 N. L. R. B. 840 (1955).

In each of the foregoing cases there was a disaffiliation and a schism in the Union. In each of the foregoing cases the Board heard the matter on the facts and denied a motion to amend its certification stating that the Board's policy is that such matters be determined by a petition and a secret ballot of the employees concerned.

Now the Union seeks to circumvent this procedure achieving the same result by an enforcement of the Boards' orders here. The "Employer" cannot now comply with the order because it is impossible for the "Employer" to



bargain with a purported representative of its employees who, in truth and in fact, is not the representative named in the Certification of Representatives and who is being opposed by other persons claiming to have that authority.

The same policy has been followed where an international union removed defecting officers and appointed a trustee for a local. The Courts have held that the expulsion of an International Union from its parent organization coupled with disaffiliation action of the Local for reasons related to the expulsion disrupts and confuses the established bargaining relationship between the employer and the representative of the employees, creating a schism, which warrants the holding of an election despite the existence of a contract between such representatives and the employer. Therefore, the Board has found that where such a schism exists, the contract does not bar an election and has directed a representation election.

*Great Atlantic and Pacific Co.*, 120 N. L. R. B.  
No. 91, 42 Labor Rel. Ref. Man. 1022 (1958);

*Drennon Food Products Co.*, 120 N. L. R. B.  
No. 88, 42 Labor Rel. Ref. Man. 1020 (1958).

There is no evidence, nor can there be any, that the employees of The Deutsch Company voted for the Allied Industrial Workers Union of America, AFL-CIO, as their representative. What has been attempted here is to substitute the Allied Industrial Workers Union of America for Local 976. This has been sought by means of enforcing an order of the Board. However, the Board is not authorized to substitute as an exclusive bargaining representative a union for the one actually chosen by the workers

and is certified as such. To do so would be in complete violation of Section 7 of the Labor Management Relations Act of 1947 (29 U. S. C. A., Sec. 157).

In order to determine whether or not there was a loss of identity of the representative of the employee or only a change of names, the Board must examine the facts and determine the substance of the situation. It must consider whether the action has removed from the employees their basic statutory right to express their choice.

*Dickey v. National Labor Relations Board*, 217 F. 2d 652 (C. A. 6, 1954).

The Brief of the National Labor Relations Board cites *Carpenteria Lemon Assn. v. N. L. R. B.*, 240 F. 2d 554 (C. A. 9, 1956) as authority. However, that opinion does state that in matters such as this one, it is important to determine the factual issues in ascertaining the right of a successor union to assume the status of a certified bargaining agent whether the union is a continuation of the old union under a new name or an affiliation, or whether it is a substantially different organization. In the *Carpenteria* case, the factual issue was contested before a trial examiner. Even then he found that although the packing house workers had appointed a new financial administrator to replace the one previously furnished by the National Union, the officers remained the same. There was no dilution of membership as a result of the change. The contracts concluded by the union remained in effect except for the substitution of the union's new name. All of this testimony was uncontradicted.

*Carpenteria Lemon Assn. v. N. L. R. B.*, *supra*, at p. 557.

In the case now at bar, however, the factual issues have never been tried before a trial examiner or any other representative of the Board. The officers have been changed completely. A trustee has been appointed by the International Union. The "Employer" does not know whether or not contracts concluded by the previous union have remained in effect or whether membership will be diluted in the International Union.

Under all of the circumstances it appears that what has been accomplished here is an effective means of depriving The Deutsch Company employees of a voice in the choosing of their collective bargaining representative. This violates the provisions of the National Labor Relations Act as amended by the Labor Management Relations Act of 1947. If the employees are to have the right to join labor organizations of their choosing and to bargain collectively by representatives of their own choosing, they must have the right to express their choice and not be deprived of their choice by administrative technicalities employed by the National Labor Relations Board or disputes involving interunion conflicts.

Both of these have appeared here. Further, no proper hearing has ever been afforded for the determination of these issues. The Petition, therefore, of The Deutsch Company to Modify and to Set Aside the Orders of National Labor Relations Board should be granted and the Petition of the National Labor Relations Board to Enforce its Order should be denied.

## II.

Where, After a Representation Hearing, the National Labor Relations Board Made Its Purported Decision and Direction of Election, and Purported to Hold a Certification Election While the “Employer’s” Petition for Rehearing and Reconsideration and Stay of the Election Was Pending Before the Board, and Before the Board Made Its Order or Gave Notice of Its Order or Ruling Upon the Said Petition to the “Employer” or Its Agents or Attorneys, the Purported Election Was Held, the Total Number of Those Voting at the Election Equaling No More Than Forty Per Cent (40%) of the Number of the Eligible Voters Among the Employees, the Action of the Board in Purporting to Conduct an Election and in Purporting to Issue a Certification of Representatives and in Enforcing the Said Certification of Representatives by Bringing on for Hearing the Complaint Herein Was and Is an Abuse of Its Discretion, Illegal and Invalid, Since the Board Has Violated Its Rules and Regulations, the Provisions of the National Labor Relations Act, the Administrative Procedure Act, and the Constitution of the United States in Depriving the “Employer” and Its Employees of Due Process of Law.

After the Decision and Direction of Election was issued, “Employer” filed its Petition for Rehearing and Reconsideration and Stay of the Election [Resp. Ex. 6; Tr. pp. 424 *et seq.*]. The Petition was filed on July 24, 1956. The Board did not make its order on that Petition or notify Respondent, until Respondent’s attorneys and consultants received the telegrams sent by the Board on August 10, 1956 [Resp. Exs. 8 and 9; Tr. pp. 449-450].

(The General Counsel misread the telegrams in alleging in his Brief that the telegrams were sent on August 2, 1956. The Board itself acknowledges in the body of the telegrams that there was some delay. The telegrams read in the present tense—"it is hereby ordered . . .") Notwithstanding, the foregoing, the election of August 8, 1956, was purportedly conducted.

At the August 8, 1956, election, not more than forty per cent (40%) of all of the employees voted [Tr. pp. 248-249]. This should be compared with the almost unanimous vote obtained at the consent election at the Avalon Plant in November [Tr. p. 247].

The August election was held while the Petition for Rehearing and Order staying the Election was pending before the Board, and prior to the issuance of the Board's order, or even the serving of any notice of the Board's Order.

The election was not held on "Employer's" premises, and was conducted without any list of the eligible employees. In short, to rely upon the August 8, 1956, election would amount to disenfranchising the employees at the Avalon Plant.

The "Employer" properly filed a Petition for Reconsideration to protect its rights and apprise the Board of the error in its Decision and Direction of Election.

*Foreman & Clark, Inc. v. N. L. R. B.*, 215 F. 2d 396 (C. A. 9th, 1954).

Where the results of election were so dubious and inequitable as to render the election invalid, a refusal of the



employer to bargain with the Union designated by that election is not an unfair labor practice.

*N. L. R. B. v. Wilkening Manufacturing Co.*, 207 F. 2d 98 (1953).

Enforcement of the Board's order involves the exercise of an equitable jurisdiction, and in that exercise, an examination of the manner of conducting of the Board election becomes significant.

The Board has expressed the opinion that there is no provision in the rules and regulations of the National Labor Relations Board for a Petition for Reconsideration. It overlooks the provisions of Section 102.60 of the Rules and Regulations of the National Labor Relations Board, which specifically provide for a further hearing as the Board may determine.

Unless a Petition for Reconsideration is filed by the "Employer," setting forth its objections to the Decision and Direction of Election, and raising the questions it desires to be opened or reopened, the "Employer" may be considered to have waived them.

*National Carbon Co.*, 110 N. L. R. B. 2184 (1954);  
*Superior Sleeprite Corporation*, 109 N. L. R. B. 322 (1954).

While the Petition for Reconsideration was pending, the Board should have stayed the election, since the outcome of that election could not be determinative while the Decision and Direction of Election was challenged.

*Administrative Procedure Act*, 5 U. S. C. A., Secs. 1004(b), 1005(d), 1007(b).

To conduct an election prior to notifying the “Employer” of the Board’s ruling on the Petition for Reconsideration, deprives the employees of the fullest freedom in exercising their rights to determine their collective bargaining representative.

*National Labor Relations Act*, Sec. 9(b);

29 U. S. C. A., Sec. 159(b).

Upon the August 8, 1956 election and the Certification of Representatives, an order might issue from the Board and the Court of Appeals of the Ninth Circuit might enforce it by ordering the “Employer” to bargain with an exclusive representative not desired by the employees, in a unit inappropriate for purposes of collective bargaining. Failure of the “Employer” to comply might result in a citation for contempt. This would not only deprive the “Employer” of due process of law by refusing it a proper determination of the unit of its employees appropriate for collective bargaining purposes before proceeding with the election, but it would also deprive the employees of their rights under the Act and of the due process afforded them by the United States Constitution, Fifth Amendment.

III.

- A Complaint Alleging a Violation of Section 8(a), (1) and (5) of the Act on the Ground That "Employer" Refused to Bargain With the Union as the Exclusive Representative of the Employees in a Unit for Bargaining Consisting of the Production and Maintenance Employees at Both of the Plants, Which Unit Is Inappropriate for the Purposes of Collective Bargaining Within the Meaning of Section 9(b) of the National Labor Relations Act, Should Be Dismissed.
- A. The Only Unit Appropriate for Purposes of Collective Bargaining, Under Section 9(b) of the National Labor Relations Act, Is the Single Plant Unit, and a Company Unit Is Inappropriate, Where the "Employer" Has Two (2) Plants Which Are Geographically Separated, Which Manufacture Different Products and Sell the Products Separately Out of Separate Sales Departments and Separate Catalogs, Which Separate Plants Are in Different Cities, and Are Operated Under Separate Autonomous Plant Managers, With the Authority to Hire and Fire Employees, Each Responsible Only to the Board of Directors of the "Employer's" Corporation, Where the Separate Plants Have Different Working Conditions and Hours of Work, Where the Skills Employed in Each of the Separate Plants Are Different From Those Employed in the Other, the Employees in One Plant Being Mostly Highly Skilled Machinists (the Avalon Plant), and the Employees in the Other Plant Being Unskilled Assemblers and Packagers (the Regent Plant), Where Each Plant Has Rates of Pay Different From the Other, Where the Classification of the Workers by Sex Is Predominantly Male at the Avalon Plant, and Almost Entirely Female at the Regent Plant, Where the "Employer" Has No Uniform Personnel Policy for Both of its Plants, There Being an Incentive Plan at

the Avalon Plant, and No Incentive Plan at the Regent Plant, Where There Is No Interchange of Personnel Between the Plants nor Uniform Seniority List Between the Plants and Where the Majority of the Production and Maintenance Employees at One Plant, by Secret Ballot Election, Expressed Their Wish Not to Be Represented by the Union (the Avalon Plant), While It Was and Is Believed, in Good Faith, by Both the Union and the "Employer" That a Majority of the Production and Maintenance Employees at the Other Plant (the Regent Plant) Did Desire Representation by the Union.

The determination of the unit appropriate for collective bargaining is of vital concern to the "Employer." In the present labor market, the employees are quick to reject employment where working conditions are not to their liking, where they suspect arbitrary treatment or feel deprived of their rights. Thus, the desire of the employees to be represented in a particular unit and by a particular Union is deserving of great respect. The employer who disregards these matters may lose his working force. Many of the employees have been employed by "Employer" for a long time. They are a good working force. The "Employer," for reasons of loyalty to them,, as well as the business purposes of retaining a good working force, is obliged to exert its best efforts to obtain recognition for their expressed preferences.

The complete record in this case uncontradictedly shows that the following significant elements distinguish each of the two plants from the other :

(1) The plants are physically separated, being approximately two and one-half to three miles apart, and in separate cities. The Avalon Plant is in Los Angeles, and the

Regent Street Plant is in Huntington Park. By reason thereof, the plants pay separate sales and license taxes, and are subject to different municipal ordinances, regulation and administration [Tr. pp. 164-165].

(2) The Avalon Plant manufactures and produces approximately fifty to one hundred various products, generally rivets, screws machine products, and valves of various types. The Regent Street Plant assembles Army-Navy fittings, electronic aircraft fittings, and some commercial hydraulic fittings [Tr. pp. 165, 176, 311].

(3) Generally, the Avalon Plant is a machine tool shop, consisting of machine operators, forge operators, drill press operators, polishers, burrers, and assemblers and packers of its products. The Regent Street Plant, on the other hand, is an assembling and packing operation. Avalon receives none of the products of Regent Street, while the Regent Street Plant does receive approximately  $8\frac{1}{3}$  per cent of Avalon's monthly output for its requirements in its assembly functions [Tr. pp. 311-313].

(4) The job classifications at Avalon consist of 22 separate classifications, as follows:

Automatic Screw Machine Operators

Turret Lathe Operators

Shucker Operators

Milling Machine Operators

Drill Press Operators

Tappers

Punch Press Operators

Production Grinders

Forge Press Operators

Die Cast Operators



Polishers and Deburrers  
Inspectors  
Wash House Operators  
Tool and Die Makers  
Tool Grinders  
Tool Crib Attendants  
Yard Workers  
Maintenance Man  
Assemblers  
Packers  
Shipping and Receiving Clerks—and  
Production Control Clerks.

At Regent Street, on the other hand, there are only 4 job classifications, consisting of assemblers, packagers, shipping and receiving clerks, and production control clerks. Although the names of the 4 classifications at Regent Street also are used in classifying jobs at Avalon, there is no duplication of the functions. The assemblers at Avalon, for example, are also drill press operators, and work a substantial amount of the time as drill press operators. The assemblers at Regent, however, are unskilled assemblers, working upon the products being assembled there [Tr. pp. 311-313].

(5) The employees at Avalon number approximately 375, while those at Regent Street number approximately 85. Two-thirds of the Avalon employees are male, while seven-eighths of the Regent Street employees are female [Tr. p. 313]. The majority of the Avalon employees are highly skilled machine operators, as many as 250 being numbered in this category. Regent Street, on the other hand, has 50 unskilled assemblers, 20 unskilled

packagers, 10 unskilled shipping and receiving clerks, and 2 production control clerks.

(6) The working hours are entirely different at the two plants, since Avalon has two shifts, each shift having two sections, one for male employees, and one for female employees. The Regent Street Plant, on the other hand, has only one shift for both male and female. The rest periods, in addition, differ between the two plants. The Avalon Plant regularly works overtime, on a schedule of overtime work on Saturday every other week. Regent Street, on the contrary, very rarely works overtime, and then only irregularly [Tr. pp. 165, 313-315].

(7) There is no uniform labor policy for the two plants, since, for example, incentive pay is available at Avalon, but not at the Regent Street Plant. There is no interchange of the personnel between the Avalon and the Regent Street Plant, and there is no uniform seniority list for both of the two Plants [Tr. p. 315].

(8) Each of the Plants has its own customers, which are serviced by separate sales departments, using separate catalogs [Tr. pp. 168-169, 317].

(9) Each of the plants is operated under an autonomous supervisor. Mr. Philip Holzman is the Manager of the Avalon Plant, and Mr. Edward Jones is the manager of the Regent Street Plant. Each of these Managers reports to the Board of Directors of the Company [Tr. pp. 171-172, 315-316].

(10) Not only does each of the Plants have separate working conditions, hours, rates or pay, and generally distinct interests among its employees on the subject of collective bargaining, but, in addition, the sentiment of

the employees at each of the Plants differs in the desire for representation by the Union for collective bargaining. A majority of the employees at the Regent Street Plant did favor representation by the Union, while at the Avalon Plant the majority do not desire representation by a Union for purposes of collective bargaining [Tr. pp. 247, 315].

Under similar circumstances, the Board has found separate Plant units appropriate. In *Mullins Lumber Company*, 94 N. L. R. B. 28 (1951), the separate Plant units were found to be appropriate, in view of the separate supervision in each Plant, the considerable autonomy maintained at each Plant, the different skills required of the employees in particular Plants, and the lack of contact and interchange among the employees. This was true in spite of the fact that one payroll clerk, working at one of the Plants, prepared the payrolls for all of the operation, and although one bookkeeper maintained the books for the Plants. Moreover, one maintenance crew maintained and serviced all equipment for all of the Plants, and even, in some instances, skills at the lumber plant and sawmill plant were similar.

The facts with regard to The Deutsch Company and its employees more conclusively establish the appropriateness of separate Plant units than the authority of *Mullins Lumber Company* requires.

Where the hours of work vary between two stores, and separate hiring and firing is done in each store, there being no interchange of clerks from store to store, and seniority being on individual store basis, the single store of a chain was found to be the appropriate unit, even though the

local store managers who had autonomy in the hiring and firing of the employees could not grant wage increases.

*V. J. Elmore Stores, Inc.*, 99 N. L. R. B. 1505 (1952).

The fact that top management may have its headquarters at one particular plant, and there establish broad policies in the engineering or administration or labor relations fields, does not preclude a Board finding that a single Plant unit is appropriate.

*Northrup Aircraft, Inc.*, 110 N. L. R. B. 1349 (1954).

See, also:

*In re Clark Thread Company, Employer, and Textile Workers Union of America*, 79 N. L. R. B. 542 (1948);

*In re Foremost Dairies, Inc. and Amalgamated Meat Cutters and Butchers Workmen of America*, 80 N. L. R. B. 764 (1948);

*Charles Ingram Lumber Co.*, 100 N. L. R. B. 440 (1952).

Even where a district manager is responsible for operation of all the stores in a district, and establishes personnel and labor policies for the entire district, and all the hiring and wage increases are subject to his approval, and discharges may be made only by him, the separate store was considered the appropriate unit, since the local store managers retained a certain degree of autonomy, and supervised daily operations and although there were temporary interchanges among the employees between the stores.

*In re Liggett Drug Company*, 110 N. L. R. B. 949 (1954).

Traditionally, where the various considerations are evenly balanced with regard to the determination of the appropriate unit (which “employer” does not concede), the determining factor is the desire of the employees themselves.

See:

*Globe Machine and Stamping Company*, 3 N. L. R. B. 294 (1937).

Where the two groups at a trucking company’s terminal and at its general office, worked under different immediate supervision, had different work schedules, and where the work at the terminal pertained only to the terminal, and the work at the general office pertained to all the terminals of the Company, there was some basis for a multi-plant unit, since the employees had similar skills and duties, the wage rates were comparable, although there was some interchange of employees. But, even so, a self-determination election was ordered.

*Pacific Inter-Mountain Express Company*, 105 N. L. R. B. 480 (1953).

See, also:

*In re David Matson Company*, 109 N. L. R. B. 184 (1954);

*In re Lumber Fabricators, Inc.*, 110 N. L. R. B. 187 (1954);

*Sprague Electric Company*, 98 N. L. R. B. 533 (1952).

By all the indicia which have been used by the Board and by the Courts, the single plant unit is the only appropriate unit of the employees for collective bargaining under Section 9(b) of the Act. There is no evidence to support, nor can there be any evidence to support, a multi-plant or a company unit in this case.



B. Where the "Employer" Has Not Refused to Bargain With the Union on the Basis of the Unit Appropriate for Collective Bargaining Purposes Under Section 9(b) of the National Labor Relations Act, a Complaint Alleging a Violation of Sections 8(a), (1) and (5) for Refusal to Bargain Will Be Dismissed.

The National Labor Relations Act requires the "employer" to bargain with the representatives of its employees, subject to the provisions of Section 9(a).

*National Labor Relations Act*, Sec. 8(a)(5);  
29 U. S. C. A., Sec. 158(a)(5).

Section 9(a) defines the exclusive representative of the employees for purposes of collective bargaining as the representative in a unit appropriate for purposes of collective bargaining. This determination is to be made to assure the fullest freedom to the employees in exercising their rights guaranteed by the National Labor Relations Act.

*National Labor Relations Act*, Sec. 9(b);  
29 U. S. C. A., Sec. 159(b).

However, if the unit is, in fact, inappropriate, the employer would violate the rights of the employees and the provisions of the Act in bargaining with a purported representative for an inappropriate unit.

*Endicott-Johnson Corp.*, 108 N. L. R. B. 88 (1954).

See, also:

*Goddard & Co., Inc.*, 105 N. L. R. B. 849 (1953).

Thus, the employer's refusal to bargain, even with a certified Union, which is not the representative of the employees in an appropriate unit, is not a violation of Section 8(a)(5) of the Act.

*Carson Pirie, Scott & Company*, 75 N. L. R. B. 1244 (1948).

IV.

The Board's Purported Decision and Direction of Election Does Not Conclusively Determine the Issue of What Is the Appropriate Unit for Purposes of Collective Bargaining Upon a Complaint Based on an Alleged Charge by the Union That the "Employer" Has Violated Section 8(a), Subsections (1) and (5), of the Act in Refusing to Bargain With the Union, Where, Since the Representation Hearing There Has Been Either Evidence Newly Discovered Which Would Affect the Determination of the Appropriate Unit or Where, Since the Representation Hearing, There Has Been a Change of Circumstances or Where the Finding of the Board as to the Appropriate Unit in Its Decision and Direction of Election and Its Conduct of the Election Was Arbitrary and an Abuse of Its Process.

- A. A Finding of the Board as to the Appropriate Unit Is Not Conclusive and Should Be Set Aside Where There Is Evidence Newly Discovered Since the Representation Hearing That the "Employer" and the Union Agreed That a Separate Plant Unit Was the Appropriate Unit and to Conduct a Consent Election Wherein the Employees Voted on a Single-Plant Basis in a Secret Ballot Consent Election Conducted by the Union and the "Employer" to Determine Whether They Desired to Be Represented by the Union for Purposes of Collective Bargaining and Where, Upon a Vote of One Hundred Per cent (100%) of the Eligible Employees at the Avalon Plant, a Majority Thereof Voted Against Representation by the Union.

At the time of the Representation Hearing in Case No. 21-RC-4365, substantially all of the testimony involved the determination of who were supervisory employees,

which issue the Union ultimately conceded. The Hearing Officer did not receive evidence, and so the Board could not consider the effect of such matters as the similarity of working conditions, the character of the plants, the anticipated effectiveness of any particular unit in maintaining industrial peace through collective bargaining, whether or not the employees at each of the plants had distinct interests from employees of the other plant, whether or not there was a history of collective bargaining, the difference in working conditions, hours, wages, and manufacturing processes and, most important, what, if any, was the desire of the employees at each of the plants for representation [Tr. pp. 164-200].

See:

*Pittsburgh Plate Glass Company v. N. L. R. B.*,  
313 U. S. 146 (1941).

The purported Decision and Direction of Election was therefore based upon evidence insufficient to find what unit of employees was appropriate for Collective Bargaining.

The Decision and Direction of Election based on the Representation Hearing is, of course, not subject to direct review.

*Pittsburgh Plate Glass Company v. N. L. R. B.*,  
*supra*;

*American Federation of Labor v. N. L. R. B.*, 308  
U. S. 401 (1940).

Therefore, the review of the finding and determination of the issue of the appropriate unit is subject to challenge only when, after hearing upon a Complaint alleging an unfair labor practice, such as a refusal to bargain, the issue of the appropriateness of the unit is raised.

The finding of the Board based upon the Representation Hearing is not conclusive under certain circumstances on the issue of the appropriateness of the unit at the hearing upon the Complaint alleging unfair labor practice.

*Baker and Taylor Co.*, 109 N. L. R. B. 245 (1954).

Where the determination of the unit was so arbitrary as to make its approval an abuse of discretion, the finding in, and the direction of the Decision and Direction of Election, and the Certification of Representatives, is not conclusive at the hearing upon the Complaint. Furthermore, where there is newly discovered evidence unavailable at the time of the Representation Proceedings, or any change in the facts from those underlying the situation at the time of the Representation Hearing, the appropriateness of the unit is subject to challenge.

*Baker and Taylor Co.*, *supra*;

*American Steel Buck Corporation*, 110 N. L. R. B. 2156 (1954).

It has been established, without contradiction, that no evidence was introduced upon the time of the Representation Hearing, nor was any evidence available on the sentiment of the employees at either of the plants separately or together, to determine whether the employees desired to be represented by the Union for the purposes of Collective Bargaining [Tr. pp. 247, 307-310, 319-320].

Those who conducted the August 8, 1956, election after the Representation Hearings, had no list of the employees [Tr. pp. 248-249]. There was no positive way of determining whether or not the persons voting were

employees eligible to vote even under the unit designation in the Decision and Direction of Election. A Certification of Representatives based upon the August 8th election disenfranchises the employees.

However, on November 12, 1956, the Union and the "Employer" agreed in writing to a consent election to determine whether or not a majority of the production and maintenance employees at the Avalon Plant desired to be represented by the Union [Resp. Ex. 4; Tr. pp. 238-240, 306, 322-324].

The Board, therefore, had before it new evidence, newly discovered and not available at the Representation Hearings that the Union regarded the sentiment of the employees at the Avalon Plant as determinative of whether or not the Union should be the bargaining agent for the Avalon employees. Mr. Doria himself stated that if he did not have a majority at the Avalon Plant, he did not want to represent them [Tr. pp. 239-240].

Newly discovered evidence not available at the time of the Representation Hearings is the result of the consent election, wherein all of the eligible employees at the Avalon Plant voted. A majority of the Avalon Plant voted against representation by the Union, although a majority, it is conceded, at the Regent Plant did favor Union representation. This evidence is particularly significant in view of the importance which is attached to the desire of the employees of one plant for Union representation, while the other plant's employees rejected the Union, and all of the other determinative factors involved establish that the single plant unit is the only appropriate unit. Together with the distinctions between the employees at each of the



plants in working conditions, pay, hours, different skills involved, autonomous management, and dissimilarity between the employees at each of the plants, their separate desires with respect to Union representation conclusively proves that the only effective unit in maintaining industrial peace through collective bargaining is the separate plant unit.

*Pittsburgh Plate Glass Company v. N. L. R. B.,  
supra.*

B. A Finding of the Board as to the Appropriate Unit Is Not Conclusive and Should Be Set Aside Where There Is a Change of Circumstances Since the Representation Hearing That the "Employer" and the Union Agreed That a Separate Plant Unit Was the Appropriate Unit and to Conduct a Consent Election Wherein the Employees Voted on a Single-Plant Basis in a Secret Ballot Consent Election Conducted by the Union and the "Employer" to Determine Whether They Desired to Be Represented by the Union for the Purposes of Collective Bargaining and Where Upon a Vote of One Hundred Per Cent (100%) of the Eligible Employees at the Avalon Plant, a Majority Thereof Voted Against Representation by the Union.

The evidence is undisputed that since the Representation Hearing, the Union entered into an agreement [Resp. Ex. 4], whereby the Union explicitly agreed to the holding of a private, secret ballot consent election for the determination of whether or not a majority of the production and maintenance employees at the Avalon Plant desired to be represented by the Union. The Union further agreed that in the event representation by it was rejected by these employees, it would not negotiate or bargain further with

regard to the employees at the Avalon Plant [Tr. pp. 238-240, 306, 322-324].

Thereafter, the entire of the production and maintenance employees eligible to vote at the Avalon Plant voted, and by a vote of one hundred sixty-nine (169) to one hundred thirty-seven (137), rejected representation by the Union [Tr. p. 247].

The Union, having entered into an agreement whereby it expressly consented to an election to determine whether or not it represented a majority at the plant, and by reason thereof, that the appropriate unit for the representation of the employees was the single plant unit, that if it lost the election, it would not proceed to bargain further with regard to the employees of Avalon. The Union has, therefore, abandoned its representation of the employees at the Avalon Plant.

A majority of the Union members at their meeting approved the Union's entering into the Agreement of November 12, 1956 [Tr. pp. 337, 368-372]. Thereafter, the employees, at the Avalon Plant, given the opportunity to express their preference, decided against no representation.

It has been the opinion of the Courts that the National Labor Relations Board should not force an unwanted bargaining representative upon the employees.

*N. L. R. B. v. Hamilton*, 220 F. 2d 492 (C. A. 10th, 1955);

*Frank Bros. v. N. L. R. B.*, 321 U. S. 702 (1944).

Where the Union has agreed after the Union members themselves had approved the agreement, to accept the decision of a majority of the Avalon employees in a consent

election as determinative of whether or not they desired to be represented by the Union, the Board should not force the bargaining representative on the Avalon employees. All of the parties involved agreed to that decision and should respect it.

Thus, the circumstances having significantly changed from those upon which the Board made its Decision and Direction of Election, the finding with respect to the unit appropriate for collective bargaining is not conclusive here.

*Baker and Taylor Company, supra;*

*Pittsburgh Plate Glass Company v. N. L. R. B., supra.*

**C. A Finding of the Board as to the Appropriate Unit Is Not Conclusive and Should Be Set Aside Where the Board Acted Arbitrarily and Abused Its Processes in Making Its Finding and Its Decision and Direction of Election Based Thereon, Directing an Election Among the Employees in a Company Unit Consisting of the Production and Maintenance Employees in Both of the Plants, Where There Was Not Sufficient Evidence at the Representation Hearing to Support Such a Finding, and Where Such a Finding and Direction of Election Is Contrary to the Evidence Upon the Representation Hearing and the Law.**

On the state of the record at the Representation Hearing, evidence was not sufficient to support the finding that the Company unit was appropriate for purposes of collective bargaining under Section 9(b).

The Decision and Direction of Election [General Counsel's Ex. 2] concedes that a single plant unit would be

appropriate [Tr. p. 339]. Some of the statements in the Board's finding are clearly erroneous, as, for example, that eighty per cent (80%) of the Regent Plant's assembly components come from Avalon. The true fact is that Regent receives only eight and one-third per cent ( $8\frac{1}{3}\%$ ) of Avalon's output for its assembly functions [Tr. p. 311]. There is further *no* interchange of personnel between the two (2) plants, and the employees at each of the two (2) plants have substantially different, not similar, skills [Tr. pp. 311-314]. The Respondent's plants are not centrally administered, functionally integrated nor does Respondent have any uniform personnel policy [Tr. pp. 165, 171-172, 313-316].

The evidence at the Representation Hearing proved that each of the plants is under separate administration, with autonomous control of the plant manager over the plant [Tr. pp. 171-172, 315-316]. There is no interchange in the personnel. The plants are operated on different shifts with different hours, and the majority of the employees in each are different sexes, the Avalon Plant being substantially male and the Regent Plant substantially female [Tr. pp. 165, 313-315]. Furthermore, no mutual interests on the subject of collective bargaining exists between the two (2) plants, since the employees at the Avalon Plant, are, in the main, highly skilled machine tool workers, while all of the employees at the Regent Plant are unskilled assemblers or packagers. Even the assemblers at the Avalon Plant are also drill press operators, and have different wage scales and conditions of work than do the assemblers at the Regent Plant [Tr. pp. 311-313].

Respondent has no uniform personnel policy for both plants. There is incentive pay at the Avalon Plant, but not at the Regent Plant. There is no single seniority list for both Plants [Tr. p. 315].

The Board acted arbitrarily and abused its discretion in finding on this evidence that the appropriate unit, for the purposes of collective bargaining, is the company unit.

Where the finding by the Board of the unit appropriate for collective bargaining was arbitrary, and an abuse of discretion, the finding will not be conclusive at a hearing upon a Complaint for an alleged refusal to bargain in violation of Sections 8(a), (1) and (5).

*Baker and Taylor Company, supra;*

*Pittsburgh Plate Glass Company v. N. L. R. B.,  
supra.*



V.

Where the "Employer" Negotiated With the Union, and Bargained With the Union, and After so Doing, Entered Into an Agreement in Writing With the Union, Which Agreement Was Authorized by the Union's Membership, That the Union and the "Employer" Would Conduct Among the Employees at One of the Plants, a Private Consent Election in Accordance With the Procedure and Regulations of the National Labor Relations Board to Determine Whether These Employees Desired to Be Represented by the Union, and the Said Election Was Conducted Pursuant to the Terms of the Said Agreement, at Which Election All of the Eligible Employees at the Said Plant Voted, and the Results of the Said Election Conclusively Established That a Majority of the Employees Did Not Desire to Be Represented by the Union, the Union Is Bound by the Said Agreement and the Results of the Said Election That It Would Not Continue to Act as the Collective Bargaining Representative of the Said Employees at the Said Plant, and the Said Agreement, and the Said Election, Constitute Bargaining Between the "Employer" and the Union, and Are of Full Force and Effect as Determining the Rights of the "Employer," the Union, and the Employees, and the "Employer" Has Bargained With the Union, as Required by Section 8(a)(5) of the National Labor Relations Act, and Has Not Interfered With, nor Restrained, nor Coerced Its Employees in the Exercise of Their Rights Guaranteed Under Section 7 of the Act, nor Has the "Employer" Violated Section 8(a)(1) of the Act, and the Union Is Estopped From Contending That It Is Not Bound by the Said Agreement and

the Results of Said Election or That the "Employer" Has Violated Sections 8(a)(1) and 8(a)-(5) of the National Labor Relations Act, or That Any Question "Affecting Commerce" Exists Concerning Representation of the Employees Under Sections 9(c), 2(6) and 2(7) of the National Labor Relations Act.

The evidence is uncontroverted that whatever requests were made of the "Employer" by the Union were in good faith met by the "Employer" [Tr. pp. 274-282, 303-305, 372-373, 375-377, 284-286, 288-289]. The Act only requires good faith bargaining, with the purpose of reaching an agreement; it does not require that a particular form of the agreement be reached.

*National Labor Relations Act*, Sec. 8(d);

29 U. S. C. A., Sec. 158(d);

*N. L. R. B. v. Whittier Mills Co.*, 123 F. 2d 725 (C. C. A. 5, 1941).

See also:

*N. L. R. B. v. Norfolk Shipbuilding and Drydock Corporation*, 195 F. 2d 632 (C. A. 4, 1952).

This does not, of course, mean that the Board or the Court will make collective bargaining agreements for the Union, or prescribe what shall be written into them, and neither the Courts nor the Board will interfere in negotiations between the employer and representatives of the employees, as long as they are being carried on in good faith.

*N. L. R. B. v. Corsicana Cotton Mills*, 179 F. 2d 234 (C. C. A. 5, 1950).

The “Employer” complied with the request of the Union that the “Employer” enter into an agreement to hold a secret ballot consent election to determine the wishes of the majority of the employees at the Avalon Plant [Tr. pp. 238-240, 306, 322-324]. The election was held [Tr. p. 249]. Following the results of that election, and acting upon and following faithfully the provisions of that Agreement, the “Employer” has proceeded to bargain further with the Union as to various matters at the Regent Plant [Tr. pp. 284-286, 288-289]. The meeting of December 4, is evidence of that.

Thus, where there was a request to enter into a written agreement on terms which were agreeable to both the Union and the “Employer,” such an agreement was executed. As long as the company has not refused to bargain and meets with the Union to discuss its proposals in good faith and to agree to matters as to which there is agreement, there is no refusal to bargain.

*Marshall Car Wheel and Foundry Co.*, 105 N. L. R. B. 57 (1953).

There is no question that the “Employer” did bargain on every paragraph in the collective bargaining agreement form at the December 4 meeting [Tr. pp. 284-286].

See:

*N. L. R. B. v. San Angelo Standard, Inc.*, 228 F. 2d 504 (C. A. 5, 1955);

*American Laundry Machinery Company*, 107 N. L. R. B. 1574 (1954).

“Employer” at all times acted in good faith. Its doubt as to the appropriateness of the unit was, and is, held

in good faith. The Union has conceded that, having entered into the agreement of November 12, 1956. The "Employer's" good faith doubt is borne out by the clear-cut results of the November 16 consent election. Under these circumstances, the actions of the Respondent cannot be considered a violation of Section 8(a)(5) of the Act.

*Little Champ Manufacturers, Inc.*, 104 N. L. R. B. 985 (1953);

*H. Wenzel Tent and Duck Company*, 101 N. L. R. B. 217 (1952).

See also:

*Industrial Stationery & Printing Co.*, 103 N. L. R. B. 1011 (1953);

*Buzza Cardoza*, 97 N. L. R. B. 1342 (1952);

*Gazette Publishing Co.*, 101 N. L. R. B. 1694 (1952);

*Chalet, Inc.*, 107 N. L. R. B. 109 (1953);

*Ferguson-Steere Motor Co.*, 111 N. L. R. B. 1076 (1955).

The evidence conclusively proves the agreement of all the parties who may be involved here. In the first place, the Union members themselves consented to the Union's entering into the agreement [General Counsel's Ex. 14; Tr. p. 365] to determine the desires of the employees for Union representation, and that representation be based upon a single plant unit for collective bargaining. The Union and the Company thereupon entered into the written agreement [Resp. Ex. 4; Tr. pp. 375-377] and finally, the majority of the employees at the Avalon Plant voted against representation by the Union [Tr. p. 247].

An analogous case is *Mid-Continent Petroleum Corp. v. N. L. R. B.*, 204 F. 2d 613 (C. A. 6th, 1953), cert. den. 346 U. S. 856 (1953). In *Mid-Continent Petroleum Corp.*, the employer was held not guilty of the charge of refusing to recognize or bargain collectively with a certified representative as the collective bargaining representative of his employees, where the employees themselves had determined that they did not desire the certified union as their bargaining representative, and had so notified the employer. There, the Union and Union members had not agreed to accept the employees' wishes as determinative, which additional elements do exist in the facts here.

*Brooks v. N. L. R. B.*, 348 U. S. 96 (1954), bears little resemblance to the uncontradicted facts in this case. In *Brooks*, neither the Union membership nor the Union agreed to the rejection of the Union by the employees. Moreover, the employees' rejection was made in the form of a letter addressed to the employer and signed by the employees, numbering a majority, who did not desire the Union to represent them. An open letter might carry some connotation of pressure upon the employees, and the Supreme Court properly distinguished between rejection by open letter and a determination by secret election. In the latter procedure the privacy and independence of the voting booth is protected. But here, the Union agreed to a secret ballot consent election to ascertain the employees' desires. *Brooks*, therefore, is distinguishable, since here the Union agreed to the election and the "privacy and independence of the voting booth" was preserved. (See *Brooks v. N. L. R. B.*, 348 U. S. at 100.)



The employees should not be prevented by an order of the Board or of a court from fairly choosing their own representative for collective bargaining (*N. L. R. B. v. Red Arrow Freight Lines*, 193 F. 2d 979 (C. A. 5, 1952)).

The employees should not be prevented by an order of the Board or of the Court from fairly choosing not to be represented by a Union. This is the only conclusion that can be drawn from the declaration of the "rights of employees" set forth in Section 7 of the Act, which gives them the right to self-organization, to form, join, or assist labor organizations, and also "the right to refrain from any or all of such activity. . . ."

This Agreement of November 12, 1956 [Resp. Ex. 4; Tr. pp. 375-377] having been entered into in the State of California, is subject to interpretation under and pursuant to the laws of the State of California. By this Agreement, the Union rescinded and abandoned their rights, if any, by the mutual consent of the Union and the "Employer," concurred in by the Union membership and the employees.

*Cal. Civ. Code*, Sec. 1689, sub. 5.

An abandonment may be implied from the acts of the parties, including a repudiation of the rights by one of the parties, and the acquiescence of the other in such repudiation.

*McCreary v. Mercury Lumber Distributors*, 124 Cal. App. 2d 477, 268 P. 2d 762 (1954);

*Desert Seed Co. v. Garbus*, 66 Cal. App. 2d 838, 195 P. 2d 184 (1944);

*Gardner v. Shreve*, 89 Cal. App. 2d 804, 202 P. 2d 322 (1949).

Employees who have designated a Union as their bargaining representative by signing cards, could disclaim the Union as their bargaining representative, and the employer would not be guilty of an unfair labor practice in following the wishes of a majority of the employees.

*N. L. R. B. v. Mayer*, 196 F. 2d 286 (C. A. 5, 1952).

See, also:

*N. L. R. B. v. Reeder Motor Co.*, 202 F. 2d 802 (C. A. 6, 1953).

Here, all of the parties did, by their acts and by their consent, agree that if the majority of the employees voting in the consent election at the Avalon Plant decided against representation by the Union, the Union would thereupon not request further bargaining with respect to the Avalon Plant.

The Union, its members, the employees eligible to vote at the Avalon Plant, and the "Employer" all agreed to the conducting of, and the Union and "Employer" did conduct a self-determination election, at which the Union was rejected. This shows the true intent of all of the parties involved, including the employees.

The Board has held that there was no violation of Section 8(a)(5) of the Act, where a Union demanded a meeting with the company, and at the meeting outlined various methods to be utilized in resolving the question of whether or not the Union represented a majority of the employees. The Union requested the Company to sign an interim agreement in order to secure a speedy determination of the majority question, and the Union

conditioned any obligation on the part of the Company to engage in collective bargaining upon the Union's receiving a majority of the votes cast in the election.

*Eaton Bros. Corp.*, 98 N. L. R. B. 464 (1952).

Here, as in the *Eaton Bros.*, the Union was simply endeavoring to determine its majority status at Avalon by an election pursuant to an agreement. This is insufficient to support a violation of Section 8(a)(5) of the Act. By reason thereof, there can be no violation here of Section 8(a)(1) of the Act, nor is there any question "affecting commerce" concerning the representation of the employees under Sections 9(c), 2(6) and 2(7) of the National Labor Relations Act.

In *The Matter of the Sullivan Company*, 84 N. L. R. B. 226 (1949), the Board reversed the Trial Examiner, and held that the Company had not violated Section 8(a)(5) of the Act where the Union was requesting a determination by the employees as to whether they wanted the Union to represent them as their bargaining representative. Note that in *Sullivan Company*, as well as here, the Union did not represent a majority.

See, also:

*Matter of Bausch & Lomb Optical Company*, 69 N. L. R. B. 1104 (1946);

*N. L. R. B. v. Valley Broadcasting Company*, 189 F. 2d 582 (C. A. 6th, 1951).

In essence, therefore, the duty of the "Employer" to bargain arises only upon the Union's request.

The obligation to bargain is not renewed after a single refusal, but can only be claimed to be a continuing obligation when requests are made.

*American Federation of Grain Millers A. F. of L.  
v. N. L. R. B.*, 197 F. 2d 451 (C. A. 5th, 1952).

### Conclusion.

For reasons stated hereinabove, the Petition of the Board should be denied and the Petition of The Deutsch Company should be granted.

Respectfully submitted,

COYLE & COOPER,

*Attorneys for Petitioner Respondent,  
The Deutsch Company.*

LEON M. COOPER,  
*Of Counsel.*

In the United States Court of Appeals  
for the Ninth Circuit

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NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

THE DEUTSCH COMPANY, RESPONDENT

---

On Petition for Enforcement of an Order of  
the National Labor Relations Board

---

BRIEF FOR THE  
NATIONAL LABOR RELATIONS BOARD

---

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FILED

JUL 23 1958





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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 15889

NATIONAL LABOR RELATIONS BOARD, PETITIONER

*v.*

THE DEUTSCH COMPANY, RESPONDENT

---

**On Petition for Enforcement of an Order of  
the National Labor Relations Board**

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**BRIEF FOR THE  
NATIONAL LABOR RELATIONS BOARD**

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**JURISDICTION**

This case is before the Court upon the petition of the National Labor Relations Board pursuant to Section 10 (e) of the National Labor Relations Act, as amended (61 Stat. 136, 29 U.S.C., Sec. 151 *et seq.*), for enforcement of its order issued against The Deutsch Company, herein called respondent, on September 14, 1957 (R. 81-85).<sup>1</sup> The Board's decision

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<sup>1</sup> "R" references are to the printed record. References preceding a semicolon are to the Board's findings; succeeding references are to the supporting evidence. Relevant provisions of the Act appear in the Appendix, *infra*, pp. 34-39.

and order (R. 29-85) are reported at 118 NLRB 1294.<sup>2</sup> This Court has jurisdiction of the proceeding, the unfair labor practices having occurred in Los Angeles County, California, where respondent is admittedly engaged in the manufacture for interstate commerce of aircraft parts and components and of screw machine products (R. 31; 8, 13).

### STATEMENT OF THE CASE

The Board's order here rests upon its finding that respondent, in violation of Section 8 (a) (1) and (5) of the Act, refused to bargain with the Union<sup>3</sup> duly certified by the Board as the representative of employees of respondent in a single two-plant unit found by the Board to be appropriate. Denying the charge that it unlawfully refused to bargain, respondent has asserted as its principal defenses: (1) that the Board abused its discretion in finding a single two-plant unit, rather than separate plant units, to be appropriate; (2) that the election proceedings conducted by the Board were tainted with irregularity; (3) that a private election conducted at one of the plants subsequent to respondent's refusal to bargain in the unit certified by the Board showed

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<sup>2</sup> The Board denied respondent's petition for rehearing on November 7, 1957 (R. 103-104).

<sup>3</sup> The certification ran to United Industrial Workers Local 976, UAW, AFL-CIO (R. 33; 342-343). This certification was thereafter amended, without objection, by changing the Union's name to United Industrial Workers Local 976, International Union, Allied Industrial Workers of America, AFL-CIO. No issue is presented respecting this change (R. 33; 343-344).

that a majority of the employees at that plant did not desire the Union to represent them; and (4) that the Union, by agreeing to the private election and participating therein, waived its right to represent the employees under the Board's certification. The subsidiary facts pertinent to these asserted defenses and the Board's findings are set forth below.

### I. The Board's Findings Of Fact

#### *A. The Board finds a single two-plant unit appropriate and directs an election*

On March 28, 1956, the Union filed a petition with the Board requesting certification as the bargaining representative in a single unit comprising all of respondent's production and maintenance employees.<sup>4</sup> These included the employees of both the Avalon Boulevard and Regent Street plants of respondent (R. 162-163). Respondent took the position that the employees of each plant should constitute separate

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<sup>4</sup> The petition, which gave respondent's address as "7000 S. Avalon Blvd., Los Angeles," was amended early in the hearing to show the address as also including "6345 Regent St., Huntington Park" (R. 162-163). Prior to the amendment, however, the Union's representative stated that the Union considered the employees of both plants to constitute a single appropriate unit R. 163). At one point during the third day of the hearing, the Union's representative, in order to expedite a determination of the representation question, expressed a willingness to stipulate that the two plants constituted separate appropriate bargaining units, but when advised by the hearing officer that such a stipulation would not necessarily expedite the determination, he elected to proceed on the basis of his claim that a single unit was appropriate (R. 190-199).

bargaining units (R. 163-164). Two unions other than the petitioning union intervened in the representation proceeding and, although willing to accept the unit desired by the petitioning union, took no firm position on the unit issue (R. 191).<sup>5</sup> The facts relevant to the unit issue, as developed at the representation hearing and found by the Board, are set forth below.

Respondent is a corporation engaged in the manufacture and sale of aircraft parts and components and screw machine products (R. 31; 8, 13). Its two plants are located in Los Angeles County about 2½ miles from each other (R. 34, 339; 162-163, 164). The Regent Street plant, the smaller of the two, was acquired about 1954 apparently because additional space was needed for respondent's operations (R. 34, 339; 180). More than 80 percent of the components assembled at the Regent Street plant come from the Avalon Boulevard plant, which is essentially a large machine shop manufacturing metal components (R. 34, 339; 183). A closing of the Regent plant would curtail the operations of the Avalon plant about 50 percent (R. 183).

A single purchasing department is maintained at Avalon (R. 181-182, 183-184), and neither plant is charged for any items it receives from the other (R. 174-175, 182). The accounting department issues a single operating statement for the Company and both

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<sup>5</sup> The intervenors were United Auto, Aircraft, Agricultural Implement Workers of America, UAW-AFL-CIO and International Association of Machinists, AFL-CIO, District No. 94 (R. 160, 161).

plants use the same bank accounts (R. 167-168, 178). The two plants have a "composite" bookkeeping setup maintained at Avalon where a single payroll for both is kept (R. 34, 339; 166, 169, 175, 180, 189). The same payroll account number is used for social security and unemployment insurance purposes (R. 167). Although each plant does its own hiring and employees are not ordinarily interchanged between the two plants, a "uniform" personnel policy is established by respondent's board of directors governing, *inter alia*, vacations, wages, and bonuses (R. 34, 339; 172, 173, 174). The employees of both plants are covered by insurance under a single policy carried by respondent (R. 168). And finally, although the Avalon plant is essentially a machine shop and the Regent plant an assembly operation, both employ certain employees with similar skills, for several of the departments, such as assembly, shipping and receiving, are "the same or similar" (R. 34, 339; 165, 176-178).<sup>6</sup>

On the basis of the foregoing facts, the Board concluded that "because of the centralized administration and functional integration of the two plants, the similar skills of the employees, and the uniform per-

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<sup>6</sup> Whatever differences prevail in the skills of the employees, these were not among "the major differences" cited by respondent's secretary-treasurer, Holtzman; these differences were, at most, only "differences in detail" (R. 164-166). Nor were any such differences among the grounds upon which respondent was "content to rest its case in support of its contention that there should be two separate units established" (R. 199-200).



sonnel policy," a single unit of the production and maintenance employees of both plants was appropriate (R. 34-35, 339). It accordingly directed that an election be held in the two-plant unit (R. 338-341).

***B. The Board denies respondent's motion for rehearing and reconsideration***

The election was scheduled for August 8. On July 24, respondent filed a document with the Board asking the Board (1) for a rehearing and reconsideration of its decision; (2) to suspend the election pending such redetermination; (3) to permit respondent to adduce additional evidence; (4) to vacate the decision and direction of election; and (5) to dismiss the representation petition (R. 35-36; 424-446). In its motion respondent argued that the Board's unit determination was inconsistent with some Board determinations in other cases; that certain testimony bearing on the unit issue was not fully developed by respondent at the hearing because respondent's representatives assumed that the Board would adhere to its past policies and find separate plant units to be appropriate; and that testimony of a more detailed nature would reveal pertinent differences in production and working conditions at the two plants.

On August 2, the Board issued a telegraphic order denying respondent's motion "for the reason that it presents no issues which were not previously considered by the Board" (R. 36; 352-353). Although copies of this order were sent to all parties, respondent failed to receive a copy until August 10. The copy it received at that time recited "Delay due to GSA

error not National Labor Relations Board" (R. 36; 251-252, 449-451).<sup>7</sup> However, respondent admittedly received notice on more than one occasion between August 2 and August 8 that the election would be held on the appointed day, and respondent's secretary-treasurer, Holtzman, conceded that he also "may have" been specifically advised that respondent's motion had been denied (R. 36-37; 326, 329-330, 357).

*C. The election and the Union's certification as bargaining representative*

The election was held on August 8 as scheduled. At the Avalon plant, because of respondent's refusal to permit the use of its premises for the election, polling booths were set up by Board election officials on the sidewalks outside the plant (R. 37; 211, 249, 327-328, 329, 358). Ballots were cast by 230 of the approximately 460 employees at both plants who were eligible to vote. Of the 230 votes cast, 207 were for the Union, 1 was for an intervening union, 20 were against either union and 2 ballots were challenged (R. 37; 350-351). None of the parties at any time filed objections to the conduct of the election,<sup>8</sup> and on

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<sup>7</sup> The reference to "GSA" meant the General Services Administration and its teletype system (R. 36).

<sup>8</sup> Section 102.61 of the Board's Rules, Series 6, then in effect (29 C.F.R. 102.61), renumbered in Series 7 as Section 102.69 (23 F.R. 3268) provides in pertinent part:

Upon the conclusion of the election, the regional director shall cause to be furnished to the parties a tally of the ballots. Within 5 days after the tally of ballots has been furnished, any party may file with the regional

August 20 the Union was duly certified as bargaining representative in the unit found appropriate by the Board (R. 38; 207, 248, 342-343).

*D. Respondent's refusal to bargain*

Following a number of telephonic communications between the parties, the Union's secretary-treasurer, Doria, wrote to respondent on September 14, asking that a date be selected to commence negotiations for a contract covering the two plants, and enclosing a proposed form of agreement. The letter also requested respondent to furnish certain wage and other information "in order \* \* \* to properly enable [the union] to bargain" (R. 39-40; 223, 345-347). On September 24 respondent wired the Union that all meetings should be arranged with respondent's "des-

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director four copies of objections to the conduct of the election or conduct affecting the results of the election, which shall contain a short statement of the reasons therefor. Such filing must be timely whether or not the challenged ballots are sufficient in number to affect the results of the election. Copies of such objections shall immediately be served upon each of the other parties by the party filing them, and proof of service shall be made.

If no objections are filed within the time set forth above, if the challenged ballots are insufficient in number to affect the result of the election, and if no run-off election is to be held pursuant to section 102.62, the regional director shall forthwith issue to the parties a certification of the results of the election, including certification of representatives where appropriate, with the same force and effect as if issued by the Board, and the proceeding will thereupon be closed.

ignated representative, H. Devoe Rea & Associates" (R. 40; 375).

A meeting was held on September 26. Doria represented the Union. Respondent was represented by Rea and Aiken, members of the Rea firm. Rea announced respondent's position to be that the Board election was invalid, that the election did not reflect the desires of the employees, and that the Union had therefore been improperly certified. Rea nevertheless undertook to advise Doria whether respondent would change its mind (R. 41; 213-215, 217, 274-276, 290-291). However, a letter from the Union, dated October 1, requesting a meeting to discuss certain alleged anti-union activities, discrimination and unilateral dealings respecting bargaining matters in both plants went unanswered by respondent (R. 42; 213, 348-349). A telephone conversation thereafter between Doria and Aiken confirmed that respondent had withheld from its representatives authority to bargain in the two-plant unit and wanted to test the Board's certification in the courts (R. 42, 43; 214, 219).

At that time, as admitted by Aiken, "One of the major decisions, probably the major decision was the question of negotiating on the basis of the unit as set forth by the Board's certification or whether we would negotiate on the Regent Street separately" (R. 278). But Aiken and Rea consistently adhered to the position that respondent would not recognize the Union as representative of the employees at the Avalon plant (R. 42; 214-215, 221-222, 255, 290-291, 295).



On November 1, following the filing of the Union's charge with the Board, Aiken wrote to the Board's Regional Office that "the Company's admitted failure and refusal to collectively bargain with said Union" was justified by the invalidity of the Board's certification (R. 43-44; 353-355).

Meanwhile, Rea had failed to respond to a proposal which Doria had sent at Rea's request in the latter part of October in an effort "to get the parties together for the purposes of bargaining" (R. 45-46; 217-218). In this proposal Doria had suggested separate agreements for each plant, provided, however, that neither was to be effective until both were executed. The proposal further stated, "nor shall the division of the two plants for the purpose of establishing the two agreements be construed as a waiver on the part of the Union of the appropriateness of the single collective bargaining unit for the two Deutsch plants involved." (R. 46; 374-375).

In view of respondent's intransigent denial of the Union's representative status at the Avalon plant, Doria proposed late in October that a card check be conducted among the Avalon employees. This was rejected by respondent (R. 44-45; 279, 295-296). Respondent countered with a proposal that a private election be held at the Avalon plant, and notified the Union that it would adhere to its refusal to bargain at Avalon "unless and until a free election by secret ballot is held to determine the wishes of the majority" at that plant. The Union yielded after much protest, but never agreed that the Board's certification was to be affected thereby (R. 46-47, 48; 258-259, 264-



265, 281-282, 297-299, 359, 364-365, 366-368, 370-371).

The agreement for the conduct of the private election, entered into on November 12, set forth in full in the Trial Examiner's intermediate report (R. 51-52), provided that if the Union won, the Company would bargain without further objection to the Board's unit finding; but that if the Union lost, the Union would refrain from any strikes or related pressure<sup>9</sup> and respondent would refrain from any anti-union activity, "until the question of representation is tested and determined by the circuit court of appeals" (R. 52-53; 236-237, 301, 365-367, 375-377. In this connection the Union issued a statement to the employees, informing them (R. 366-367):

THIS VOTE TO PROVE UNION MAJORITY  
HAS NOTHING TO DO WITH THE GOV-  
ERNMENT VOTE WHERE THE UNION  
WON ELECTION. THIS VOTE IS NOT A  
NEW ELECTION

The results of this vote will have nothing to do with the election that was conducted by the Government and which was won by the Union. This vote is only being taken in the hope that the results will make any further action by the Government unnecessary. This vote cannot change the results of the Government election. The Union will still be certified by the Government in both plants regardless of the outcome of this vote. THIS VOTE IS ONLY FOR THE PUR-

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<sup>9</sup> During the period when respondent was refusing to bargain pursuant to the certification, the Union had been conducting sporadic strikes at both plants (R. 41; 275-277, 372-373).

POSE OF PROVING THE UNION MAJORITY IN THE AVALON PLANT SO THAT INSTEAD OF GOING THROUGH MONTHS OF GOVERNMENT "RED TAPE," CONTRACT NEGOTIATIONS CAN START IMMEDIATELY IN BOTH PLANTS.

IF UNION WINS VOTE:

1. Bargaining starts immediately in both plants.
2. All Government "red tape" for enforcement will no longer be necessary.
3. From 3 to 18 months of time will be saved.

IF UNION LOSES VOTE IN AVALON PLANT:

1. The Union agrees to wait until the Government enforces the order for the Company to bargain on a contract.
2. The Union still remains certified as the Union in both plants of the Deutsch Company. Nothing will be lost.

The private election at Avalon was held on November 16 and resulted in a vote of 169 to 137 against the Union. In addition, 49 employees who had been challenged were excluded from the ballot by mutual agreement (R. 53-54; 246-247).

The parties met again on December 4, with Doria renewing his request for bargaining at both plants and stating he had relinquished no claim concerning the Union's status at Avalon. Respondent refused to discuss any contract covering the Avalon employees and it was agreed that further negotiation was futile (R. 54; 224-225, 227-229, 264-266, 287, 299-301).

## II. The Board's Conclusions Of Law

Upon the foregoing findings, the Board, affirming the Trial Examiner, concluded that respondent had refused to bargain with the Union in violation of Section 8 (a) (5) and (1) of the Act (R. 81, 74, 76). It refused to permit relitigation of the appropriate unit question determined in the representation proceeding (R. 56-57, 59), rejected respondent's contention that the August election was invalid (R. 59-64), held the November election to be without effect "as it was a private election conducted in only one of two plants which the Board had previously found constituted a single appropriate unit and in which the Union was certified" (R. 81, 64-67), and rejected respondent's argument that it had bargained in good faith (R. 68-74).

## III. The Board's Order

The Board's order, in the usual form, requires respondent to cease and desist from continuing its unfair labor practices or violating the employees' rights "in any like or related manner." (R. 81-82). It affirmatively directs respondent, upon request, to bargain with the Union in accordance with the Board's certification, and to post appropriate notices (R. 82-85).<sup>10</sup>

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<sup>10</sup> On September 30, 1957, respondent filed with the Board a motion for rehearing and reconsideration of the Board's decision and order, alleging, in addition to matters already presented to the Board, that respondent was faced with conflicting claims by persons purporting to represent the Union and suggesting that the Union certified by the Board

## SUMMARY OF ARGUMENT

The record amply supports the Board's finding that respondent refused to bargain with the certified Union in the appropriate unit as determined by the Board. Indeed, the facts constituting such refusal were admitted by respondent. Since the unit determination was proper under the Board's wide discretion, and since the election conducted by the Board in such unit in August was valid and respondent, in any event, waived any right to object to any matters affecting the results of the election by its failure to file timely objections, respondent's refusal to bargain violated Section 8 (a) (5) of the Act, as the Board concluded.

The subsequent election in November had no effect upon the Union's representative status pursuant to the certification. The Union could not lawfully have agreed to represent only part of the employees in the certified unit and it did not purport to make such an agreement.

Respondent's attempt to reopen the representation question in the complaint proceeding was not based on newly discovered evidence, or on evidence unavailable in the representation proceeding, and the Board

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might no longer be in existence; respondent, however, did not indicate any willingness to bargain with the certified union or its accredited representatives if ascertained (R. 86-101). The Union, on October 2, 1957, filed an opposition to respondent's motion (R. 101-103). Upon consideration of the matter, the Board, on November 7, 1957, denied respondent's motion "on the ground that insufficient cause has been shown to warrant changing" its prior decisions and orders (R. 103-104).

properly refused to allow relitigation of the matter. Moreover, respondent's request to the Board, following its receipt of the Board's decision and order, for leave to adduce additional evidence was properly denied; and respondent's similar request to this Court should be denied. With respect to the unit issue, respondent alleged no material newly discovered or previously unavailable evidence. And if by reason of any internal union dissension subsequent to the Board's order, any question should arise as to the identity of the certified union or its accredited representatives at a time when respondent is ready to honor a request to bargain pursuant to the Board's order, such question may then be determined by the Board or other appropriate forum.

## ARGUMENT

### **I. The Board Properly Found That Respondent Refused To Bargain With the Certified Union In The Unit Found Appropriate By The Board**

Section 8 (a) (5) of the Act makes it an unfair labor practice for an employer "to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9(a)." Section 9 (a), in turn, provides that representatives selected for the purposes of collective bargaining "by the majority of the employees in a unit appropriate for such purposes shall be the exclusive representatives of all the employees in such unit for the purposes of collective bargaining in respect to rates of pay, wages, hours of employment, or other conditions of employment." And Section 9 (b) declares that "The Board



shall decide in each case whether, in order to assure to employees the fullest freedom in exercising the rights guaranteed by this Act, the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof."

The facts detailed *supra* (pp. 8-12) amply support the Board's finding that respondent refused to bargain collectively with the representatives of its employees certified by the Board in "the unit appropriate for the purposes of collective bargaining" as determined by the Board. The bargaining unit found appropriate was the employer unit consisting of both the Avalon and Regent plants. This was the unit covered by the Union's bargaining request which it addressed to respondent on September 14 following the Board's certification of the Union as the bargaining representative for employees in that unit. From the outset, respondent took the firm position, to which it consistently adhered thereafter, that it would not bargain for the Avalon plant because the Union did not represent a majority of the employees in that plant and that the Board had erred in finding that the two plants constituted a single appropriate unit. Indeed, "the Company's admitted failure and refusal to collectively bargain with said Union" was acknowledged by respondent in its letter to the Board that followed the filing of the charge herein (R. 354). And on November 9, in a communication addressed to all its employees, it admitted its "position" to be "that before we would enter into negotiations with this union for the employees at the Avalon plant, they

would first have to prove in a free election, and by secret ballot, that they do, in fact, represent the majority of you people" (R. 364, 359).

Respondent nevertheless contends that it bargained in good faith with the Union because, following the Board's certification, it negotiated with the Union with respect to a determination of the majority status of the Union at the Avalon plant and entered into an agreement with the Union for a privately conducted employee election at that plant (R. 147-148, 150). This position is plainly untenable. The Union's status as the bargaining representative of employees in the employer unit, which the Board had determined pursuant to Section 9(c) of the Act, was not a bargaining matter. "This status is acquired by statute and is not within the area of collective bargaining" even though the employer acts "in good faith." *N.L.R.B. v. Wooster Division of Borg-Warner Corporation*, 236 F. 2d 898, 904 (C.A. 6) affirmed, 356 U.S. 342, 349, 350; *McQuay-Norris Mfg. Co. v. N.L.R.B.*, 116 F. 2d 748, 751, 752 (C.A. 7), certiorari denied, 313 U.S. 565. As the Supreme Court recently held, it is "unlawful to insist upon matters" outside "the scope of mandatory bargaining." *N.L.R.B. v. Wooster Division of Borg-Warner Corp.*, 356 U.S. 342, 349. Such an insistence, "against the permissible opposition of the [Union], amounted to a refusal to bargain as to the mandatory subjects of collective bargaining" (*id.* at 348).

Also in point here is *Douds v. International Longshoremen's Association*, 241 F. 2d 278 (C.A. 2),

wherein the union insisted, over the employer's objection, on bargaining with respect to a different unit of employees from the one certified by the Board as appropriate. Holding that the union's insistence was violative of its bargaining obligation under the Act, the Court stated, in language which precisely fits respondent's action here (241 F. 2d at 282, 283):

This distinction between private bargaining over conditions of employment and administrative determination of the unit appropriate for bargaining is clear. The parties cannot bargain meaningfully about wages or hours or conditions of employment unless they know the unit of bargaining. That question is for the Board to decide on a petition under Section 9 (c) of the Act, and its decision is conclusive on the parties, cf. *Brown, for and on behalf of N.L.R.B. v. Pacific Tel. & Tel. Co.*, 9 Cir., 218 F. 2d 542, 544, although the decision may subsequently be changed.

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The process of change not permitted by the Act is one that denies the Board this ultimate control of the bargaining unit and disrupts the bargaining process itself. This is precisely what occurs when, after the Board has decided what the appropriate bargaining unit is, one party over the objection of the other demands a change in that unit. Such a demand interferes with the required bargaining "with respect to rates of pay, wages, hours and conditions of employment" in a manner excluded by the Act. It is thus a refusal to bargain in good faith within the meaning of Section 8(b)(3).

And compare this Court's holding in *N.L.R.B. v. Retail Clerks International Ass'n*, 203 F. 2d 165, 169-170, that unions may not "condition their *duty* to bargain collectively for the bargaining unit which they represent, as to 'wages, hours, and other terms and conditions of employment' upon the employer's bargaining with a class of employees *outside* the unit."

Plainly, therefore, the Board was correct in holding that respondent refused to bargain with the Union. Whether this refusal was lawful depends on the validity of respondent's other asserted defenses, to which we now turn.

## II. The Board's Determination Of The Appropriate Bargaining Unit Was Proper

Respondent's chief contention in the representation and unfair labor practice proceedings has been that the Board erred in finding the employer unit, rather than the plant units, appropriate. As we show below, the Board's determination of the unit issue was reasonable and is therefore binding on the parties.

Section 9 (b) of the Act commits to the Board the authority to determine in each case whether "the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof." In exercising this authority, the Board's discretion is very broad. As this Court stated in *Foreman & Clark, Inc. v. N.L.R.B.*, 215 F. 2d 396, 405, certiorari denied, 348 U.S. 887:



*The Board's Determination Of The Appropriateness Of A Unit Will Not Be Set Aside Unless It Is "Arbitrary Or Capricious".*

Great latitude is given to the Board in determining "the unit appropriate for the purposes of collective bargaining."

In *Packard Motor Car Company v. National Labor Relations Board*, 1947, 330 U.S. 485, 491, 67 S. Ct. 789, 793, 91 L. Ed. 940, the Court used the following language:

"The issue as to what unit is appropriate for bargaining is one for which no absolute rule of law is laid down by statute, and none should be by decision. It involves of necessity a large measure of informed discretion and the decision of the Board if not final, is rarely to be disturbed."

The Board's determination in this case that the employer unit was appropriate was not "arbitrary or capricious." The evidence summarized in the Statement, *supra*, pp. 4-5, consisting almost entirely of the testimony of respondent's secretary-treasurer, furnishes ample basis for the Board's finding that the appropriate bargaining unit here was a single employer unit. Respondent's two plants are only about 2½ miles apart. They are functionally integrated as indicated by the fact that more than 80 percent of the parts used at the Regent plant come from the Avalon plant and a shutdown of the Regent plant would curtail the operations of the Avalon plant by about 50 percent. The two plants, moreover, are centrally administered. They have a composite book-keeping set-up maintained at Avalon; a single payroll is kept for both plants; a single purchasing department is maintained at Avalon and neither plant is



charged for any items it receives from the other; the accounting department issues a single operating statement for the Company; and both plants use the same bank accounts. Several of the departments at each of the plants, such as assembly, shipping and receiving, are the same or similar and employ persons of similar skills. And finally, a uniform personnel policy is established by respondent's board of directors.

It was "because of the centralized administration and functional integration of the two plants, the similar skills of the employees, and the uniform personnel policy" thus established by the foregoing facts that the Board found the single employer unit to be appropriate here (R. 34-35). Far from being arbitrary or capricious, this determination was eminently reasonable.

The Board observed that certain factors (such as the physical separation of the plants, the separate sales offices, the fact that each plant does its own hiring, and the lack of interchange of employees between the plants) could have justified separate plant units, as urged by respondent. However, it did not deem these factors to be of sufficient weight to overbalance the considerations militating for a single employer unit. In so holding, the Board did not embark on an uncharted sea. No two cases are quite alike in this field. But within the bounds that the numerous factors entering into a unit determination and the flexibility of each permit precedent to be a guide, the instant determination finds ample support in prior Board and court decisions.<sup>11</sup>

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<sup>11</sup> See, for example: *Pittsburgh Plate Glass Co. v. N.L.R.B.*, 313 U.S. 146, 164-165; *Foreman & Clark, Inc. v. N.L.R.B.*,

It is precisely in circumstances like these, where more than one unit determination could appropriately be made, that the "large measure of informed discretion" lodged in the Board (*supra*, p. 20) becomes most meaningful. The exercise of this discretion is most needed when, as here, the various conflicting factors are so balanced that the determination turns on the nicest distinctions. Accordingly, in just such a situation, "the decision of the Board if not final, is rarely to be disturbed." *Packard Motor Car Co. v. N.L.R.B.*, 330 U.S. 485, 491; *N.L.R.B. v. Smith Co.*, 209 F. 2d 905, 907 (C.A. 9).

### III. The Board Properly Rejected Respondent's Contention That The Election Conducted At Its Avalon Plant Was Invalid

Although in the representation proceeding respondent filed no objections to the election, as provided by the Board's rules and regulations, it later contended in the unfair labor practice proceeding that the election was invalid because of alleged irregularities in the conduct of the election at the Avalon plant. It asserted that because it had not received notice of the Board's denial of its petition for reconsideration of the Board's decision and direction of election at the time the election was conducted, it refused to co-

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215 F. 2d 396, 398-399 (C.A. 9), certiorari denied, 348 U.S. 887; *N.L.R.B. v. Williams*, 195 F. 2d 669, 670-672 (C.A. 4), certiorari denied, 344 U.S. 834; *N.L.R.B. v. A. K. Allen Co.*, 252 F. 2d 37, 38-39 (C.A. 2); *North Memphis Lumber Company*, 81 NLRB 745; *Pine Hall Brick and Pipe Company*, 93 NLRB 362; *Coburn d/b/a Coburn Catering Corporation, et al.*, 100 NLRB 1133. See also, *Riegel Paper Corporation*, 96 NLRB 779.

operate with Board election officials at its Avalon plant by furnishing a list of its employees or permitting its premises to be used in connection with the balloting. Respondent alleged that, as a result, the Board representatives set up polling booths on the sidewalk outside the plant, that employees desiring to vote had to stand in line and execute affidavits as to their employee status before voting,<sup>12</sup> and that because of this inconvenience and the reluctance of some of the employees to miss time from their work to vote, only about 40 percent of the employees at that plant voted. Respondent's belated contentions based on these alleged facts (set forth in an offer of proof (R. 248-249)) were properly rejected by the Board.

In the first place, respondent, having failed to file any objections to the election within five days after being furnished with a tally of the ballots, as provided by the Board's rules and regulations,<sup>13</sup> was precluded in the unfair labor practice proceeding from urging any defense to its refusal to bargain based upon the conduct of the election or conduct affecting the results of the election. Here, as in *N.L.R.B. v. National Mineral Co.*, 134 F. 2d 424, 426 (C.A. 7), certiorari denied, 320 U.S. 753, "the employees have not protested at all, and the employer has raised the

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<sup>12</sup> Cf. *N.L.R.B. v. National Mineral Co.*, 134 F. 2d 424, 428 (C.A. 7), certiorari denied, 320 U.S. 753, where, because of the employer's refusal to cooperate, a similar procedure was employed by the Board.

<sup>13</sup> See Section 102.61 of the Rules and Regulations, Series 6 (29 C.F.R. 102.61), then in effect, renumbered Section 102.69 in Series 7 (23 F.R. 3268), now in effect (*supra*, p. 7, n. 8).

question belatedly." This failure to file timely objections constitutes a "fatal defect in respondent's case." *N.L.R.B. v. Conlon Bros. Mfg. Co.*, 187 F. 2d 329, 332-333 (C.A. 7). See also *Pittsburgh Plate Glass Co. v. N.L.R.B.*, 313 U.S. 146, 161-162.

Aside, however, from the untimeliness of respondent's objections, they are, in any event, without merit. Respondent had no legal right to a ruling on its petition for reconsideration of the Board's decision and direction of election. The Board's rules establish a comprehensive procedure governing the processing of representation cases (29 C.F.R. 102.52-102.62, now 29 C.F.R. 102.60-102.70 (23 F.R. 3266-3269)), but nowhere in this procedure is there a provision for motions or petitions for reconsideration. That the Board, as a matter of courtesy, may pass upon such petitions when they are filed certainly creates no right to such a ruling. But even if it should be assumed that respondent had a right to a ruling on its petition, it would stand in no better position than any party who refuses to proceed further in a proceeding because of alleged interlocutory error. Such a party may not condition his further participation upon the tribunal's reconsideration of the alleged error in advance of the conclusion of the proceeding. Much less may the party prevent the tribunal from proceeding until he receives formal notice of the ruling upon reconsideration. Cf. *The Borden Company*, 108 NLRB 807, 812, affirmed, 227 F. 2d 166 (C.A. 5). Here, as we have shown (*supra*, pp. 6-7), not only did the Board actually rule upon the motion well before the election, but respondent was on notice that the



election would be held as scheduled and, indeed, admittedly "may have" been informally advised of the denial of the motion. In these circumstances, respondent is hardly in a position to assert either a deprivation of rights or that the election was inconclusive. Cf. *N.L.R.B. v. S. H. Kress & Co.*, 194 F. 2d 444, 445-446 (C.A. 6).

Respondent apparently contends that the election was invalid because, as a result of respondent's refusal to cooperate, less than a majority of the eligible employees voted in the election at its Avalon plant. It is well settled, however, that participation by a majority in the election is not a prerequisite to a valid election, for "voters who could have voted in a formal election but do not are considered to assent to the will of the majority of those who vote." *N.L.R.B. v. Whittier Mills Co.*, 111 F. 2d 474, 477 (C.A. 5). As stated by the Supreme Court in *Virginian Railway Co. v. System Federation No. 40*, 300 U.S. 515, 560, in construing representation provisions of the Railway Labor Act similar to those of the National Labor Relations Act, "Election laws providing for approval of a proposal by a specified majority of the electorate have been generally construed as requiring only the consent of the specified majority of those participating in the election." This ruling has been uniformly followed by the courts and the Board. *N.L.R.B. v. Central Dispensary & Emergency Hospital*, 145 F. 2d 852, 853 (C.A. D.C.), certiorari denied, 324 U.S. 847, and cases cited therein; *N.L.R.B. v. Standard Lime and Stone Co.*, 149 F. 2d 435, 436-437 (C.A. 4), certiorari denied, 326 U.S. 723.



Moreover, respondent, having brought about the very conditions which it now contends detracted from the validity of the election, is in a particularly inappropriate position to complain. Respondent asserted before the Board, however, that in insisting upon a determination of its motion for reconsideration as a condition to participating in the election, it was "not asking for this for itself, but for the people who work at the Avalon plant" (R. 249-250). "In effect, [respondent] seeks to vindicate the rights of [its] employees to select their bargaining representative. \* \* \* The underlying purpose of this statute is industrial peace. To allow employers to rely on employees' rights in refusing to bargain with the formally designated union is not conducive to that end, it is inimical to it." *Brooks v. N.L.R.B.*, 348 U.S. 96, 103. See also *Foreman & Clark, Inc. v. N.L.R.B.*, 215 F. 2d 396, 406, 408 (C.A. 9), certiorari denied, 348 U.S. 887; *N.L.R.B. v. National Mineral Co.*, 134 F. 2d 424, 426-427 (C.A. 7), certiorari denied, 320 U.S. 753.

#### **IV. The Board Properly Regarded The Results Of The Private Election At The Avalon Plant, Following Respondent's Refusal To Bargain Pursuant To The Board's Certification, As Immaterial To Any Issue In This Case**

We have established above that respondent refused to bargain with the Union duly certified by the Board following a valid election in the appropriate bargaining unit. This, of course, constitutes the violation of Section 8 (a) (5) found by the Board. Respondent contends, however, that the private election held at

the Avalon plant in November, less than three months after the certification, showed that the Union was not the majority representative of the Avalon employees and, that by agreeing to such election, the Union waived all rights under the August certification. These contentions are wholly without substance, for the November election lacked legal effect.

Aside from the fact that respondent's prior refusal to bargain with the Union in the certified unit might well have affected the results of any election conducted thereafter, the results of the private election, as the Board held, were immaterial in any event, but particularly in view of the fact that that election was not in the unit which the Board had found to be appropriate and in which the Union was certified (R. 81). As we have already shown, the Board only a few months earlier had properly found the employer unit consisting of employees of both respondent's plants, rather than two separate plant units, to be appropriate for collective bargaining in this case. Respondent, in the absence of unusual circumstances not present here, was legally obliged to bargain with the Union as the representative of employees in this unit for a reasonable period, normally at least a year following the certification. *Brooks v. N.L.R.B.*, 348 U.S. 96; *Carpinteria Lemon Assn. v. N.L.R.B.*, 240 F. 2d 554, 557 (C.A. 9), certiorari denied, 354 U.S. 909.

The Union, moreover, did not purport to waive its status as the certified representative, nor could it lawfully have agreed to represent only part of the employees in the bargaining unit. As shown in the Statement, *supra*, pp. 10-12, the Union made it plain to

respondent and to the employees that it was agreeing to the private election only in the hope that, if it won, respondent would bargain in the certified unit without further delay. At the same time the Union made clear its contention that if it lost, it would be in no worse position than it was already in—that is, it would have to await a Board order and the court's enforcement of that order in the pending unfair labor practice case before respondent would obey its bargaining obligation. In point here is *McQuay-Norris Mfg. Co. v. N.L.R.B.*, 116 F. 2d 748, 751-752 (C.A. 7), certiorari denied, 313 U.S. 565, wherein the union, while pressing an unfair labor practice charge based on the employer's refusal to grant it recognition as the exclusive bargaining representative, signed an agreement in which the employer accorded it recognition for its members only. In that case, the court, rejecting a contention that the union by signing the agreement had rendered moot any issue as to the employer's refusal to grant it recognition as the employees' exclusive bargaining representative, stated:

\* \* \* the Union, after engaging in a controversy \* \* \* regarding its right to complete recognition, consented to accept the most it could obtain of a right to which it was entitled for the asking. A consent given under such circumstances cannot be utilized by [respondent] to relieve it of its statutory duty to grant complete recognition. In this connection, it seems pertinent to point out that when the Union was denied recognition in defiance of the statutory mandate, it placed its reliance upon the Board to require

[respondent] to concede that about which there was no room for controversy. That the Union pursued this lawful and peaceful method is to its credit.<sup>14</sup>

As the statutory representative of the employees in the employer unit, the Union was legally required to represent all of them. *Steele v. Louisville & Nashville R. R. Co.*, 323 U.S. 192. The "right" of "[e]mployees \* \* \* to bargain collectively through representatives of their own choosing" (Section 7 of the Act) is one which the Union could not have waived even if it had so desired. Particularly is the Union's capacity to waive its bargaining status lacking in view of the overriding public interest in Board proceedings. Indeed, the paramount character of this public interest is such that it has long been settled law that, notwithstanding the literal language of Section 7 above quoted, the rights created by the Act are public, not private. *National Licorice Co. v. N.L.R.B.*, 309 U.S. 350, 362, 364; *Amalgamated Utility Workers v. Consolidated Edison Co.*, 309 U.S. 261, 265, 268-269; *Virginia Electric & Power Co. v. N.L.R.B.*, 319 U.S. 533, 543; *Phelps Dodge Corp. v. N.L.R.B.*, 313 U.S. 177, 192-193, 197; Pope, J., concurring in *Brown v. Pacific Telephone and Telegraph Company*, 218 F. 2d 542, 544 (C.A. 9); cf. *Nathan-*

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<sup>14</sup> And cf. *N.L.R.B. v. Yawman & Erbe Mfg. Co.*, 187 F. 2d 947, 948-949 (C.A. 2), in which the court rejected the employer's contention that it had not violated Section 8 (a) (5) of the Act by refusing, during the course of bargaining, to furnish requested wage data because the union had thereafter signed a contract without receiving the requested information.



son v. *N.L.R.B.*, 344 U.S. 25, 27. And, as this Court early recognized, in harmony with uniform authority, only the Board has the power to compromise obligations arising under the Act, and settlements between the parties themselves are not binding upon the Board. *N.L.R.B. v. American Potash & Chemical Corp.*, 113 F. 2d 232, 234-235.<sup>15</sup> Cf. *N.L.R.B. v. Sunshine Mining Co.*, 125 F. 2d 757, 760-761 (C.A. 9).

#### V. There Is No Merit To Respondent's Request For Leave To Adduce Additional Evidence

In its "Petition to Modify and Set Aside Orders of the National Labor Relations Board," respondent asks this Court to permit it to adduce additional evidence with respect to (1) the propriety of the Board's "selection of the unit" and (2) "the present existence of the alleged Union" (R. 124-125). Respondent had made a similar request to the Board on September 30, 1957, shortly after the Board issued its decision and order (*supra*, p. 13, n. 10). The Board properly denied the request.

With respect to the unit issue, respondent has failed to allege any material evidence which was either

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<sup>15</sup> Accord, *Wallace Corp. v. N.L.R.B.*, 323 U.S. 248, 253-255; *N.L.R.B. v. Local 404, International Brotherhood of Teamsters, etc.*, 205 F. 2d 99, 103 (C.A. 1); *N.L.R.B. v. General Motors Corp.*, 116 F. 2d 306, 312 (C.A. 7); *N.L.R.B. v. Prettyman*, 117 F. 2d 786, 792 (C.A. 6); *Waterman S.S. Corp. v. N.L.R.B.*, 119 F. 2d 760, 762 (C.A. 5); *N.L.R.B. v. Bird Machine Co.*, 174 F. 2d 404, 407 (C.A. 1); *N.L.R.B. v. E. A. Laboratories, Inc.*, 188 F. 2d 885, 887 (C.A. 2), certiorari denied, 342 U.S. 871; *N.L.R.B. v. Hekman Furniture Co.*, 207 F. 2d 561 (C.A. 6); *N.L.R.B. v. Robinson*, 251 F.2d 639, 642 (C.A. 6).



newly discovered or unavailable in the representation proceeding. It is settled, of course, that in the absence of such newly discovered or previously unavailable material evidence, "an issue covered and decided in unit proceedings cannot as of right be relitigated in a subsequent unfair labor practice proceeding" (*N.L.R.B. v. Worcester Woolen Mills Corp.*, 170 F. 2d 13, 16 (C.A. 1), certiorari denied, 336 U.S. 903), for "a single trial of the issue [is] enough." *Pittsburgh Plate Glass Co. v. N.L.R.B.*, 313 U.S. 146, 162. Accord, *Allis-Chalmers Mfg. Co. v. N.L.R.B.*, 162 F. 2d 435, 440-441 (C.A. 7); *N.L.R.B. v. West Kentucky Coal Co.*, 152 F. 2d 198, 201 (C.A. 6), certiorari denied, 328 U.S. 866). The Trial Examiner in the unfair labor practice case expressed his willingness to permit a showing of "any change in the nature of the operation of the business" since the Board election, but respondent admitted there had been none (R. 308-309). The Examiner also indicated that he would allow a showing of a change in "job classifications," but respondent admitted that the employees were "doing the [same] work" (R. 308-309, 318-319).<sup>16</sup> The Examiner further indicated he would receive evidence of "any drastic expansion or reduction in personnel since the election," but none was offered (R. 308-309). In fact, respondent's counsel admitted that the evidence he was offering "as to the alleged

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<sup>16</sup> Respondent's contention here was simply that it had never identified the various job classifications until after the representation proceeding (R. 319). Obviously, however, the evidence was available to respondent at all times, and no explanation was offered for respondent's failure to adduce it at the earlier hearing.

differences between the two plants, is the situation that existed at the time of the original Board representation hearing" (R. 318-319). In these circumstances, the Board properly upheld the Trial Examiner's refusal to receive additional evidence on the unit issue and also properly denied respondent's request, in its petition for reconsideration, for the receipt of such additional evidence (R. 56-57, 59, 104).

The only evidence which respondent now alleges to be "newly discovered" consists of that relating to the November private election at the Avalon plant. This evidence was, however, received. And, as we have already shown, the Board correctly treated it as immaterial to any issue in this case.

The Board was also clearly warranted in rejecting respondent's request for leave to adduce evidence relative to internal differences within the Union purportedly occurring subsequent to the Board's order and bearing on what respondent termed "the present existence of the alleged Union" (*supra*, p. 13, n. 10). The Board's order requires respondent to bargain with the Union only "upon request" and if, when respondent is ready to bargain pursuant to such a request, any question such as that now raised by respondent should exist, the question may at that time be determined by the Board or other appropriate forum. Cf. *Southport Petroleum Co. v. N.L.R.B.*, 315 U.S. 100, 105-106. Enforcement of the Board's order results in no ambiguity for respondent, nor does it require respondent to bargain with any union other than that certified by the Board. No dissolution or schism or change of affiliation is or can be suggested. The only possible problem respondent

might encounter would be to ascertain the identity of the authorized agents of the certified union. And this is a problem which any employer might have to face under any bargaining order. For these reasons a case like *Dickey v. N.L.R.B.*, 217 F. 2d 652 (C.A. 6), cited by respondent, which concerns *a change in the identity of the union prior to the order to bargain*, is wholly inapplicable. Cf. *Carpinteria Lemon Ass'n v. N.L.R.B.*, 240 F. 2d 554, 556-557 (C.A. 9); *N.L.R.B. v. E. A. Laboratories, Inc.*, 188 F. 2d 885, 888 (C.A. 2), certiorari denied, 342 U.S. 871; *Continental Oil Co. v. N.L.R.B.*, 113 F. 2d 473, 477-478 (C.A. 10). Respondent's contention has "as little substance" and is as much "a smoke screen" as the contention made in *N.L.R.B. v. Harris-Woodson Co.*, 179 F. 2d 720, 723 (C.A. 4), wherein the local union, after being certified, changed its affiliation.

### CONCLUSION

For the reasons stated above, it is respectfully submitted that the Board's order should be enforced in full.

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July 1958.

## APPENDIX

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 29 U.S.C., Secs. 151, *et seq.*), are as follows:

## RIGHTS OF EMPLOYEES

SEC. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8 (a) (3).

## UNFAIR LABOR PRACTICES

SEC. 8. (a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

\*       \*       \*       \*

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9 (a).

\*       \*       \*       \*

(d) For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times



and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession: \* \* \*

\* \* \* \*

## REPRESENTATIVES AND ELECTIONS

SEC. 9. (a) Representatives designated or selected for the purposes of collective bargaining by the majority of the employees in a unit appropriate for such purposes, shall be the exclusive representatives of all the employees in such unit for the purposes of collective bargaining in respect to rates of pay, wages, hours of employment, or other conditions of employment:

\* \* \* \*

(b) The Board shall decide in each case whether, in order to assure to employees the fullest freedom in exercising the rights guaranteed by this Act, the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof:

(c) (1) Whenever a petition shall have been filed, in accordance with such regulations as may be prescribed by the Board—

(A) by an employee or group of employees or any individual or labor organization acting in their behalf alleging that a substantial number of employees (i) wish to be



represented for collective bargaining and that their employer declines to recognize their representative as the representative defined in section 9 (a), or (ii) assert that the individual or labor organization, which has been certified or is being currently recognized by their employer as the bargaining representative, is no longer a representative as defined in section 9 (a);

\* \* \* \*

the Board shall investigate such petition and if it has reasonable cause to believe that a question of representation affecting commerce exists shall provide for an appropriate hearing upon due notice. Such hearing may be conducted by an officer or employee of the regional office, who shall not make any recommendations with respect thereto. If the Board finds upon the record of such hearing that such a question of representation exists, it shall direct an election by secret ballot and shall certify the results thereof.

\* \* \* \*

(5) In determining whether a unit is appropriate for the purposes specified in subsection (b) the extent to which the employees have organized shall not be controlling.

(d) Whenever an order of the Board made pursuant to section 10 (c) is based in whole or in part upon facts certified following an investigation pursuant to subsection (c) of this section and there is a petition for the enforcement or review of such order, such certification and the record of such investigation shall be included in the transcript of the entire record required to be filed under section 10 (e) or 10 (f), and

thereupon the decree of the court enforcing, modifying, or setting aside in whole or in part the order of the Board shall be made and entered upon the pleadings, testimony, and proceedings set forth in such transcript.

\* \* \* \*

## PREVENTION OF UNFAIR LABOR PRACTICES

SEC. 10 (a) The Board is empowered, as hereinafter provided, to prevent any person from engaging in any unfair labor practice (listed in section 8) affecting commerce. This power shall not be affected by any other means of adjustment or prevention that has been or may be established by agreement, law, or otherwise: \* \* \*

(c) \* \* \* If upon the preponderance of the testimony taken the Board shall be of the opinion that any person named in the complaint has engaged in or is engaging in any such unfair labor practice, then the Board shall state its findings of fact and shall issue and cause to be served on such person an order requiring such person to cease and desist from such unfair labor practice, and to take such affirmative action including reinstatement of employees with or without back pay, as will effectuate the policies of this Act:  
\* \* \*

(e) The Board shall have power to petition any circuit court of appeals of the United States (including the United States Court of Appeals for the District of Columbia), or if all the circuit courts of appeals to which application may be made are in vacation, any district court of the United States (including the District Court of the United States for the District of Columbia), within any circuit or district, respectively, where-

in the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall certify and file in the court a transcript of the entire record in the proceedings, including the pleadings and testimony upon which such order was entered and the findings and order of the Board. Upon such filing, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter upon the pleadings, testimony, and proceedings set forth in such transcript a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the Court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive. \* \* \*

(f) Any person aggrieved by a final order of the Board granting or denying in whole or in part the relief sought may obtain a review of such order in any circuit court of appeals of the United States in the circuit wherein the unfair labor practice in question was alleged to have been engaged in or wherein such person resides or transacts business, or in the United States

Court of Appeals for the District of Columbia, by filing in such court a written petition praying that the order of the Board be modified or set aside. A copy of such petition shall be forthwith served upon the Board, and thereupon the aggrieved party shall file in the court a transcript of the entire record in the proceeding, certified by the Board, including the pleading and testimony upon which the order complained of was entered, and the findings and order of the Board. Upon such filing, the court shall proceed in the same manner as in the case of an application by the Board under subsection (e), and shall have the same exclusive jurisdiction to grant to the Board such temporary relief or restraining order as it deems just and proper, and in like manner to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board; the findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall in like manner be conclusive.

\* \* \*





No. 15893✓

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United States  
Court of Appeals  
for the Ninth Circuit

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CEE-BEE CHEMICAL CO., INC., a corporation,  
Appellant,

vs.

DELCO CHEMICALS, INC., a corporation,  
Appellee.

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Transcript of Record

In Two Volumes

VOLUME I.

(Pages 1 to 222, inclusive)

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Appeal from the United States District Court for the  
Southern District of California,  
Central Division

FILED

MAY 22 1958

PAUL P. O'BRIEN, CL



No. 15893

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\* Page numbers appearing at bottom of page of Original Transcript of Record.



In the United States District Court, Southern  
District of California, Central Division

Civil Action No. 17387-WB

DELCO CHEMICALS, INC., a corporation,  
Plaintiff,

vs.

CEE-BEE CHEMICAL CO., INC., a corporation,  
TURCO PRODUCTS, INC., a corporation,  
and DOE ONE to DOE FIVE,  
Defendants.

COMPLAINT FOR DECLARATORY JUDG-  
MENT OF PATENT INVALIDITY AND  
NON-INFRINGEMENT, UNFAIR COMPE-  
TITION, AND DAMAGES AND INJUNC-  
TIVE RELIEF UNDER SHERMAN AND  
CLAYTON ANTI-TRUST LAWS

Comes now the plaintiff, Delco Chemicals, Inc.,  
a corporation, and complains and alleges against  
the defendants, as follows:

Claim for Declaratory Judgment

1.

This claim is for declaratory judgment of patent  
invalidity and non-infringement and this court has  
jurisdiction thereof under 28 U.S.C., 2201 and  
2202, and 28 U.S.C. 1338 (a).

2.

Plaintiff is a Delaware corporation having its [2]

principal place of business in the County of Los Angeles, State of California, within the Southern Judicial District of California, Central Division.

## 3.

Defendant Cee-Bee Chemical Co., Inc. is a California corporation doing business in the County of Los Angeles, State of California, within the Southern Judicial District of California, Central Division.

## 4.

Defendant Turco Products, Inc. is a California corporation doing business in the County of Los Angeles, State of California, within the Southern Judicial District of California, Central Division, and is a licensee of defendant Cee-Bee Chemical Co., Inc. under United States Patent No. 2,653,116.

## 5.

The true names or capacities, whether corporation or otherwise of defendants Doe 1 to Doe 5 are unknown to plaintiff and when their true names are discovered leave of Court will be requested to amend this complaint accordingly.

## 6.

An actual controversy has arisen and exists between plaintiff and defendants within the Southern District of California, Central Division, with respect to each and all of the following matters, to wit:

(a) Defendant Cee-Bee Chemical Co., Inc. on

behalf of itself and as agent for defendant Turco Products, Inc. has contended and continues to contend: that on the 22nd day of September, 1953, United States Patent No. 2,653,116 was duly and legally issued to it for an invention of Keith R. Whitcomb and Eugene E. Finch for Improvement in Method of Removing Sealant from Fuel Tanks; that it is the owner of said letters patent and that plaintiff is infringing upon said letters patent by making and [3] selling apparatus for use and practice of the methods set forth and claimed in said patent and each of the claims thereof.

(b) Plaintiff has contended and continues to contend: that said patent 2,653,116 was not duly or legally issued, that said patent does not claim or cover an invention or any inventions, that use of plaintiff's apparatus does not infringe said patent, and that said patent and each of the claims thereof are invalid and void for each of the following reasons:

(1) The said Keith R. Whitcomb and Eugene E. Finch were not the original or first inventors of that which is claimed to be patented therein or thereby, or any material or substantial part thereof, but that, on the contrary, prior to the alleged invention thereof by said Keith R. Whitcomb and Eugene E. Finch, or more than one year prior to the application for said patent, the methods claimed by said patent, and particularly those which are described in the claims thereof, and all material and substantial parts thereof, had been patented, de-



scribed and published in letters patent or applications therefor as follows:

### United States Patents

Number	Name	Date
Re. 19,374	Butterworth	Nov. 20, 1934
1,141,243	Foster	June 1, 1915
1,628,141	Gray	May 10, 1927
1,666,015	Land	Apr. 10, 1928
1,701,824	Robinson	Feb. 12, 1929
1,730,658	Jensen	Oct. 8, 1929
1,892,950	Houpt	Jan. 3, 1933
2,018,757	Butterworth	Oct. 29, 1935
2,045,752	Butterworth	June 30, 1936
2,065,462	Olsson	Dec. 22, 1936
2,092,321	McFadden	Sept. 7, 1937
2,123,434	Paulson et al.	July 12, 1938
2,442,272	Jaffe	May 25, 1948
2,458,333	Brady	Jan. 4, 1949

and in the following printed publications:

Aviation's Notebook, page 166, published 1940 by Aviation, 330 West 42nd St., New York, N. Y.

Aviation Maintenance, Sept., 1944, issue, article by Major-General Clements McMullen

Oakite News Service, Jan.-Feb. 1949 issue, published by Oakite Products, Inc., New York, N. Y.

Turco for Oil Industry, published 1930 by Turco Products, Inc., Los Angeles, California

Technical Talk, published June 15, 1946 by

Turco Products, Inc., Los Angeles, California  
Technical Talk, published May 15, 1947 by  
Turco Products, Inc., Los Angeles, California  
Technical Talk, published May 15, 1946 by  
Turco Products, Inc., Los Angeles, California  
Turco Material and Methods for Cleaning  
Tank Cars, published July 2, 1930 by Turco  
Products, Inc. — copyright registered Class  
I-XXc #2502

and in other patents and printed publications the identities of which are not known at present to plaintiff but which, when ascertained, plaintiff will pray leave to add hereto by suitable amendment.

(2) The said Keith R. Whitcomb and Eugene E. Finch, the alleged inventors named in said patent 2,653,116, were not the original or first inventors of that which is claimed to be patented therein or thereby, or any material or substantial part thereof, but that on the contrary, prior to the claimed invention [5] thereof by said Keith R. Whitecomb and Eugene E. Finch, that which is claimed in and by said patent 2,653,116 and each of the claims thereof had been invented or used by or known to the patentees and persons named in the foregoing paragraph numbered 6 (b) (1), at the places of residence of the respective patentees named in said patents, and upon information and belief of plaintiff had been known to or used in the United States by the following additional persons and concerns at the addresses shown in conjunction with their respective names:

Carl Hirdler, Los Angeles, California  
Pennzoil Company, Los Angeles, California  
Douglas Aircraft Company, Santa Monica,  
California

Shell Oil Company, Martinez, California  
United Air Lines, Cheyenne, Wyoming  
Oakite Products, Inc., New York, N. Y.  
Turco Products, Inc., Los Angeles, Cali-  
fornia

Butterworth Systems, Inc., Bayonne, New  
Jersey

The Pyrate Corporation, Bayside, New York  
Union Pacific Railroad, Los Angeles, Cali-  
fornia

Atchison, Topeka and Santa Fe Railway,  
Los Angeles, California

Denver and Rio Grande Western Railroad,  
Denver, Colorado

and had been invented or used by or known to others whose addresses are at present unknown to plaintiff but which, when ascertained, plaintiff will pray leave to add hereto by amendment.

(3) That which is claimed by said patent 2,653,-116 and each of the claims thereof was in public use in the United States prior to the alleged invention thereof by said [6] Keith R. Whitcomb and Eugene E. Finch, or more than one year prior to the filing of the application for said patent, by the patentees, persons and concerns identified in paragraphs 6 (b) (1) and (2) hereof, at the places shown in said

patents as being the places of residence of said patentees and at the addresses of the remaining persons and concerns shown in said paragraphs, and by others whose names and places of use are at present unknown to plaintiff but which plaintiff will seek to add hereto by amendment when discovered.

(4) While the application for said patent 2,653,116 was pending in the United States Patent Office, the applicants therefor so limited and confined the claims thereof, under the requirements of the Commissioner of Patents, that the plaintiff herein can not now seek or obtain an interpretation thereof sufficiently broad to cover any method involved in the use of apparatus sold or used by plaintiff.

(5) The art in connection with the methods shown in said patent 2,653,116, as said art is identified in paragraphs 6 (b) (1), (2) and (3) hereof, was crowded prior to the alleged invention or discovery by said Keith R. Whitcomb and Eugene E. Finch, and the conception of the alleged invention or discovery of said patent required no invention whatsoever but only mechanical skill.

(6) The claims of said patent 2,653,116 do not cover any valid or patentable combination or method but embrace mere aggregations of elements or steps which have no patentable combination or cooperation.

(7) The specification and claims of said patent 2,653,116 are ambiguous, indefinite and uncertain, are not distinct and do not teach how to practice the alleged invention thereof and do not particu-

larly point out the parts, movements, combinations or methods which are claimed as the alleged invention of said patent, [7] and that the elements and steps of the claims of said patent were all publicly known prior to said alleged invention by the patentees named in said patents and resulted in no new or unexpected results.

## 7.

Plaintiff further alleges that, even if said patent 2,653,116 were valid and infringed by plaintiff or plaintiff's customers, which is not admitted but is denied, defendants are estopped to assert the same in a court of equity for each of the following reasons:

(a) That defendant Cee-Bee Chemical Co., Inc. wrongfully induced the Commissioner of Patents of the United States to issue said letters patent by misrepresentations and distortions of fact and by submitting to said Commissioner of Patents affidavits and arguments stating only part truths.

(b) That defendants have been and are now using said United States Letters Patent 2,653,116 as a means of maintaining an unlawful monopoly upon the sale and use of apparatus and chemicals not covered thereby.

(c) That defendants have used and are now using said letters patent 2,653,116 to intimidate the United States Air Force into paying unjust, unwarranted and exorbitant fees for using tank cleaning methods which are and have long been in the public domain.



Second Claim for Unfair Competition

For a second and separate claim against defendants, plaintiff alleges:

8.

This claim is for unfair competition and this court has jurisdiction thereof under 28 U.S.C. 1338 (b), and 15 U.S.C. 1126 (h) and (i). [8]

9.

Plaintiff repleads and incorporates herein by reference Paragraphs 2 to 7 inclusive of its first claim.

10.

Plaintiff and defendants are engaged in the business of manufacturing, selling, and leasing equipment for the cleaning of tanks and the sale of chemicals, that said business is a business in interstate commerce, and that plaintiff corporation and defendant corporation are engaged in interstate commerce.

11.

Defendant Cee-Bee Chemical Co., Inc. has been and is now committing, and threatens to continue to commit, without justification and for the purpose of interfering and damaging plaintiff's said business and good will and causing loss of profits to plaintiff, the following acts:

(a) Using, and threatens to continue to use said United States Patent 2,653,116 as a tool of unfair competition to cause plaintiff's customers and prospective customers to refuse to purchase and use plaintiff's tank cleaning apparatus and chemicals.

(b) Broadcasting, and threatens to continue to broadcast to plaintiff's customers and prospective customers and to the trade at large, unwarranted threats and notices in bad faith to the effect that such customers, prospective customers and trade will be sued by defendant if they use plaintiff's apparatus or chemicals.

12.

On December 4, 1953, defendant Turco Products, Inc. commenced an action in the United States District Court for the Southern District Court of California Central Division against defendant Cee-Bee Chemical Co., Inc. for Declaratory Judgment and Unfair Competition said action being assigned No. 16,103-C. [9]

Thereafter, during the course of said action No. 16,103-C defendant Turco Products, Inc. pleaded and alleged that the said patent 2,653,116 was invalid and brought a motion for summary judgment upon which a hearing was held, and the motion taken under submission by the Court.

14.

During the course of said action No. 16,103-C, if not before, both defendants became fully apprised of the obvious invalidity of said patent 2,653,116 in view of the prior art cited, the prior public uses, and the skill of the ordinary mechanic.

15.

Before judgment was given in said action No.

16,103-C defendants entered into a collusive and fraudulent agreement to dismiss said action, and conspired together to assert said patent in bad faith and as a fraud upon the public, and with the intent to injure plaintiff and others lawfully engaged in the business of tank cleaning and the sale of chemicals.

## 16.

That since entering into said collusive and fraudulent agreement as set forth in Paragraph 15 defendant Cee-Bee Chemical Co., Inc. on behalf of itself, and as agent for defendant Turco Products, Inc. has unlawfully and in bad faith continued and renewed the course of conduct as set forth in Paragraph 11 and threatens to continue said course of action for the purpose of interfering with and damaging plaintiff's business and good will and causing loss of profit to plaintiff.

## 17.

That by virtue of said acts of defendant, plaintiff has suffered loss of profits in the sum of fifty thousand dollars (\$50,000); and that defendant's said acts have been and are being committed willfully, wantonly and maliciously and that plaintiff [10] is entitled to exemplary damages in the sum of twenty-five thousand dollars (\$25,000).

Third Claim for Damages and Injunctive Relief  
Under Sherman and Clayton Anti-Trust Laws

For a third and separate claim against defendants, plaintiff alleges:

## 18.

This claim is for damages and injunctive relief under the anti-trust laws of the United States and this Court has jurisdiction thereof under Sections 15 and 26 of Title 15 U.S.C.A. being a part of the Act of Congress of July 2, 1890 c. 649, 26 Stat. 209 as amended entitled "An Act to Prevent Trade and Commerce Against Unlawful Restraints and Monopolies" commonly known as the Sherman Act and the Clayton Act.

## 19.

Plaintiff repleads and incorporates herein by reference Paragraphs 2 to 7 inclusive of its first cause of action.

## 20.

Plaintiff and defendants are engaged in the business of manufacturing, selling, and leasing equipment for the cleaning of tanks, and the sale of chemicals, that said business is a business in interstate commerce, and that plaintiff corporation and defendant corporation are engaged in interstate commerce.

## 21.

Defendants have been and are now engaged in a combination and conspiracy to restrain and monopolize the trade and commerce among the several states of the United States in the desealing of aircraft tanks and the sale of chemicals therefor and have attempted to restrain and monopolize the said trade in violation of Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act. [11]

## 22.

In furtherance of said combination and conspiracy, defendants entered into an unlawful agreement to assert said patent No. 2,653,116 against plaintiff and the public at large when all of the defendants are fully aware and apprised of the unenforceability and invalidity of said patent for the reasons set forth in paragraph 6 of the first claim herein and paragraphs 12 through 14, inclusive, of the second claim herein.

## 23.

Defendants have and are using threats of enforcement of said patent No. 2,653,116 to control the sale of unpatented chemicals to contractors of the United States Air Force and to others.

## 24.

Defendants have threatened and coerced prospective customers of plaintiff with patent infringement suits without any intention to bring such suits, and for the purpose of monopolizing the aircraft tank desealing business and injuring the business and good will of plaintiff.

## 25.

Upon information and belief, it is alleged that defendants have agreed to fix prices for the sale and leasing of desealing equipment, and the sale of unpatented chemicals and have agreed to divide the trade between them.



## 26.

As a direct and intended result of the activities of defendants in restraint of trade and attempting to monopolize the business of aircraft tank desealing, plaintiff has been caused to lose contracts for the sale and leasing of desealing equipment and the sale of chemicals, and has lost valuable business, good will and property in the sum of one hundred thousand dollars (\$100,000.). [12]

Wherefore, plaintiff prays judgment as follows:

1. That patent 2,653,116 and each of the claims in suit be declared invalid and void.

2. That the use of plaintiff's apparatus be declared not to infringe upon said patent 2,653,116.

3. That a preliminary and permanent injunction be issued out of and under the seal of this Court restraining defendants, their agents, employees, officers and directors, and those acting in concert with defendants, from asserting to the trade or to plaintiff's customers that any use of apparatus sold or vended by plaintiff infringes upon said patent 2,653,116 or any claim thereof, or from threatening any of plaintiff's customers with suit for infringement of said patent 2,653,116 if said customers use plaintiff's said apparatus.

4. That plaintiff receive as damages for the injury to its business the sum of One Hundred Thousand Dollars (\$100,000), and that said sum be trebled to Three Hundred Thousand Dollars (\$300,-

000), and that the court award a reasonable attorney's fee in accordance with Section 4 of the Clayton Act (15 U.S.C.A. 15) in such cases made and provided.

5. That defendants, and each of them, be permanently enjoined and restrained from each and all of the unlawful practices alleged in plaintiff's complaint.

6. That the aforesaid combination and conspiracy, contracts, agreements, arrangements, and understandings in restraint of interstate trade and commerce, conspiracy to monopolize, attempts to monopolize and monopolization of interstate trade and commerce be adjudged and decreed to be unlawful, and that the contracts, agreements, arrangements and understandings and practices alleged in this complaint be adjudged and decreed to be in violation of Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act. [13]

7. That the Court adjudge and decree that the defendants have combined and conspired to restrain unreasonably and have conspired to monopolize, attempted to monopolize and have monopolized the interstate trade and commerce and the business of aircraft tank desealing in violations of Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act.

8. That the defendants and all of their subsidiaries or affiliated companies, their officers, directors, agents and employees and their respective suc-

cessors, assignees or transferees be enjoined from agreeing, combining, conspiring or contracting with each other or with any other person or corporation whatsoever to restrain, control or eliminate competition among themselves or with others, from restraining in any way the business of aircraft tank desealing, or from conspiring or attempting to monopolize or monopolizing the trade and commerce herein alleged.

9. That the Court issue a preliminary injunction prohibiting the defendants and each of them and their officers, directors, agents and employees from in any way restricting the plaintiff's business of aircraft tank desealing by agreement or concert of action or any other illegal means.

10. That the plaintiff recover its cost herein.

11. That the plaintiff have such other and further relief as the Court may deem proper.

FULWIDER, MATTINGLY &  
HUNTLEY,

ROBERT W. FULWIDER,  
WALTER P. HUNTLEY,  
JOHN M. LEE,  
JOHN A. WEYL,

/s/ By JOHN M. LEE,

Attorneys for Plaintiff. [14]

Duly Verified. [15]

[Endorsed]: Filed October 26, 1954.

[Title of District Court and Cause.]

AFFIDAVIT OF JOHN M. LEE

State of California,  
County of Los Angeles—ss.

John M. Lee, being first duly sworn, deposes and says:

I am of counsel for Delco Chemicals, Inc., the plaintiff herein, and I have examined the record of Civil Action No. 16,103-C filed in the United States District Court, Southern District of California, Central Division, said action being for declaratory judgment of invalidity and non-infringement of patent No. 2,653,116 and unfair competition brought by Turco Products, Inc., against Cee-Bee Chemical Co., Inc. [16]

Annexed hereto and marked Exhibit 6, is a true copy of United States Patent No. 2,653,116 involved in the present action and the aforesaid action No. 16,103-C.

Annexed hereto and marked Exhibit 7, is a true copy of the affidavit of S. G. Thornbury, President of Turco Products, Inc., submitted with the Motion for Summary Judgment brought by the plaintiff Turco Products, Inc., in the aforesaid action No. 16,103-C.

Annexed hereto and marked Exhibit 8, is a true copy of the following prior patents which were submitted with the Motion for Summary Judgment in the aforesaid action No. 16,103-C:

Butterworth .....	2,108,757
Land .....	1,666,015
Robinson .....	1,701,824
Jenson .....	1,730,658

Annexed hereto and marked Exhibit 9 is a true copy of excerpts from the Motion for Summary Judgment filed by plaintiff, Turco Products, Inc., in the aforesaid action No. 16,103-C.

Annexed hereto and marked Exhibit 10 is a true copy of excerpts from the brief in support of the Motion for Summary Judgment submitted by plaintiff Turco Products, Inc., in the aforesaid action No. 16,103-C.

Annexed hereto and marked Exhibit 11 is a true copy of excerpts from the Reporter's Transcript of Proceedings at the hearing on the Motion for Summary Judgment held before the Honorable James M. Carter on July 13, 1954. [17]

Annexed hereto and marked Exhibit 12 is a true copy of the Stipulation and Order For Dismissal filed in the aforesaid action No. 16,103-C on July 16, 1954, and entered by the Clerk on July 19, 1954.

/s/ JOHN M. LEE.

Subscribed and sworn to before me this 25th day of October, 1954.

[Seal] /s/ BETTY JONES,

Notary Public in and for said County and State.

My Commission Expires September 26, 1957.

[Exhibit No. 6—K. R. Whitcomb, et al., Patent No. 2,653,116. See Exhibit A at page 225 of the Book of Exhibits.]



EXHIBIT No. 7

In The United States District Court, Southern  
District of California, Central Division

No. 16,103-C

TURCO PRODUCTS, INC., a corporation,  
Plaintiff-Counterdefendant,

v.

CEE-BEE CHEMICAL CO., INC., a corporation,  
Defendant-Counterclaimant.

AFFIDAVIT OF S. G. THORNBURY

State of California,  
County of Los Angeles—ss.

S. G. Thornbury being first duly sworn deposes  
and says:

I am President of Turco Products, Inc., (hereinafter referred to as Turco) and have been such for the past sixteen (16) years. Said Turco is a California corporation and it maintains its principal place of business in Los Angeles, County of Los Angeles, State of California.

The business of Turco is and has been the manufacture and sale of chemicals principally for commercial and industrial [20] cleaning operations which include, among various other types of cleaning operations, the cleaning of tanks, drums and radiators to remove various sorts of coatings and deposits therefrom.

## Exhibit No. 7—(Continued)

While Turco does not itself carry out the said cleaning operations, it does make and sell chemicals therefor and does recommend to its customers various cleaning methods and does sometimes make available to its customers apparatus for conducting such cleaning operations.

Among the cleaning methods and apparatus recommended and made available by Turco have been the method and apparatus disclosed in United States Letters Patent to Land No. 1,666,015 issued in 1928, under which Turco acquired license rights in or about 1930.

In the cleaning of tanks since prior to 1930 it has been conventional practice to continuously spray a recirculated solvent against the tank walls and, wherever the coatings or deposits being removed contain any particles or scale which might clog the pumping and spray lines, it has been conventional practice to screen the solvent before recirculating it. It has also been conventional practice in connection with such cleaning operations to flush the tank with rinse water for the purpose of rinsing the solvent-cleaned surface and washing out of the tank any coating particles which may have failed to drain out by gravity, said rinsing operations having been usually carried on at a relatively high pressure to insure that any particles would be physically washed from the tank. Also, where a highly volatile solvent has been used it has been conventional practice to close the openings of the tank to prevent escape of solvent vapors. It

## Exhibit No. 7—(Continued)

has also been conventional practice to apply a soapy or detergent solution to the tank before applying the rinse water wherever the desirability of a soap or detergent occurs, although many solvents are and have been of such character that it is unnecessary to apply a soap or detergent bath.

The only material difference between one cleaning operation and another is and has been that while one solvent is suitable for removing one type of coating, a different solvent may be required to remove another type of coating; and accordingly Turco has developed and made available to the trade over the years, in excess of seven hundred (700) different solvent compositions.

The need for cleaning sealant from the integral fuel tanks placed in airplane wings did not arise until sometime in 1944 and at that time Turco developed solvents suitable for removing such sealant materials and made them available to aircraft companies and also recommended for use in cleaning the sealant from said tanks not only the said method of said Land patent No. 1,666,015 but also such methods as filling the tank with the solvent and allowing it to stand until the coating was dissolved and the method which contemplated workmen entering the tank with hand sprays and spraying the solvent on localized parts of the tank walls, all of which methods have been and still are being used. As the need for portable equipment for carrying on such cleaning operations became desir-

## Exhibit No. 7—(Continued)

able, Turco made such equipment available to its customers.

/s/ S. G. THORNBURY.

Subscribed and Sworn to Before Me this 25th day of May, 1954.

/s/ OPAL M. BURROWS,

Notary Public in and for said County and State.

[Exhibit No. 8—A. B. Butterworth Patent No. 2,018,757, see page 285 of Book of Exhibits. G. M. Land Patent No. 1,666,015, see page 292. J. M. Robinson Patent No. 1,701,724, see page 298. S. K. Jensen Patent No. 1,730,658, see page 288.]

## EXHIBIT No. 9

Excerpt From The Motion For Summary Judgment—Civil Action No. 16,103-C.

Page 1, line 25, through page 2, line 9:

“The grounds for this motion are:

“1. The method claimed by the patent in suit is fully and clearly anticipated by prior patent art which was not cited or considered by the Commissioner of Patents while the application for the patent was pending and being prosecuted before the United States Patent Office;

“2. The method claimed by the patent in suit is devoid of patentable novelty;

“3. There does not exist any genuine issue as to material facts necessary to consideration and determination of this motion, since invalidity of the patent in suit is clearly apparent from a comparison of said patent in suit with said prior patents

## Exhibit No. 9—(Continued)

which were not considered by the Patent Office but which are before the Court in this motion.” [22]

## EXHIBIT No. 10

Excerpts From The Brief In Support of Motion  
For Summary Judgment—Civil Action No.  
16,103-C.

Page 1, lines 20-31:

“To determine this motion, it is not necessary to hear any testimony. The patent in suit, its file wrapper, and the prior art cited by the Patent Office are before the Court. The arguments used by the patentees of the patents in suit to persuade the Patent Office to grant the patent are before the Court as parts of the file wrapper Exhibit ‘B’. Also, the prior art which was not considered by the Patent Office, but which clearly anticipates the patent in suit, is before the Court as Exhibit ‘C’. It is only necessary, therefore, for the Court to compare this prior art with the patent in suit to determine that there is no genuine issue of fact and that the patent is clearly invalid.”

Page 2, lines 18-31:

## “The Patent In Suit

“The Whitcomb et al. patent in suit relates to a method of cleaning tanks, its stated object being to clean or remove from aircraft fuel tanks the coatings of sealing materials which are applied to the tank joints to prevent leakage. [23]

“The method described by the patent consists of spraying a solvent solution against the tank walls



## Exhibit No. 10—(Continued)

(no particular solvent being specified), draining the sprayed solvent out of the tank by gravity along with any coating particles which it removes, screening the drained solvent to separate from it any coating particles, and then recirculating the screened solvent to the sprays.”

Page 3, lines 1-6:

“The patent also mentions that, after the solvent cleaning is completed, it may be desirable to spray the tank with a soapy solution (the patent referring to this as a ‘water rinsable, emulsifying spray’), and then to rinse the tank with water. The patent also mentions that it may be desirable to heat the solvent solution before spraying it.”

Page 4, lines 19-29:

## “The Tank Cleaning Art

“As will be shown by the prior art which will be discussed hereinafter, tank cleaning by continuously spraying solvents onto the tank walls is a very old art. For instance, it has been extensively used in the cleaning of railroad tank cars, ship tanks, large drums, and automobile radiators. Such new developments as there have been during the past two decades or more have been in the apparatus used in the cleaning jobs. Different jobs require different solvents, but the general procedure is the same insofar as method is concerned.”

Page 6, lines 13-32:

“The Prior Art Which Was Not Cited By The Patent Office Completely Anticipates The Patent In Suit.

## Exhibit No. 10—(Continued)

“If the Patent Office Examiner had made a thorough search of the prior art, as he should have done, he would have found and cited prior patents which completely anticipate the method claimed by the patent in suit, even to the draining of the sprayed solvent from the tank by gravity and screening it before recirculating it. In fact, the method is found to be described so often in the prior art that it is probably unnecessary to mention specifically but a few of the prior art patents identified in the complaint and answer to the counter-claim herein. Those patents, included in Exhibit ‘D’ filed herewith are as follows:

“Butterworth .....	2,018,757
“Butterworth .....	2,045,752
“Land .....	1,666,015
“Jensen .....	1,730,658
“Olsson .....	2,065,462
“Robinson .....	1,701,824”

Page 9, lines 17 - 32; and Page 10, lines 1 - 4:

“Therefore, it is obvious from a comparison of the above-discussed prior art, which was not considered by the Patent Office, that it anticipates everything that the patentees of the patent in suit urged as being novel in order to obtain allowance of the claims of the patent in suit.

“To Use an Old Method for an Analogous  
Purpose Is Not Invention

“Since the precise method claimed in the patent in suit is shown to be old in the art of tank clean-

## Exhibit No. 10—(Continued)

ing, Defendant-Counterclaimant cannot predicate patentability upon using this old method for the analogous purpose of cleaning airplane fuel tanks, which is part of the tank cleaning art.

“In the first place, Defendant-Counterclaimant is estopped to assert that the patent in suit is not within the art of tank cleaning, because the file wrapper, Exhibit ‘B’, shows that the Patent Office considered and treated the subject matter of the patent in suit to be within that art and the patentees acquiesced in that position.”

Page 16, lines 27-32; and Page 17, lines 1-4:

“The Patent in Suit Is Void for  
Lack of Invention

“Even if we did not have in the prior art, as we do have, a full anticipation of the alleged invention of the patent in suit, still the patent lacks patentable invention, because all of the steps of the claimed method are old, and, in the aggregate of those steps set forth in the patent claims, each of those steps continues to perform its well-known old function in the same manner and nothing more. Nothing unexpected results from the aggregation of the steps.”

Page 20, lines 16 - 32, and Page 21, line 1:

“Analyzing the patent in suit in the light of this doctrine, we find that the patentees of said patent have done nothing more than use an old tank cleaning method for cleaning airplane fuel tanks and, as said in *Dow Chemical Co., v. Halliburton*, *supra*, ‘he who is merely the first to utilize the existing

## Exhibit No. 10—(Continued)

fund of public knowledge for new and obvious purposes' is not entitled to a patent monopoly upon such a use.

"If the patentees of the patent in suit had discovered some new solvent, or if they had discovered that screening a solvent had some phenomenal or unexpected effect upon it, or if they had discovered that washing an airplane fuel tank with water after a solvent spray operation produced some unexpected phenomenal result, or if they had discovered that heating the solvent to 60° - 120° F. produced some strange result not produced by heating it to any other temperature, it may be that they could be said to have made a patentable discovery, but such is not the case."

Page 21, lines 27 - 31; Page 22, lines 1 - 10:

"Conclusion

"Wherefore, plaintiff-counterdefendant respectfully submits that the facts before the Court show that there is no genuine issue of material fact as to invalidity of the patent in suit, and that summary judgment should be granted declaring the patent in suit to be invalid.

"Respectfully submitted,

"MASON & GRAHAM,  
COLLINS MASON,  
WILLIAM R. GRAHAM,  
/s/ By COLLINS MASON,  
Attorneys for Plaintiff-  
Counterdefendant."

## EXHIBIT No. 11

Excerpts From Reporter's Transcript of Proceedings, Civil Action No. 16,103-C, Hearing on Motion for Summary Judgment, July 13, 1954, United States District Court, Southern District of California, Central Division. Honorable James M. Carter, Presiding.

Page 34, line 7, through page 36, line 17:

"The Court: Well, I will take the matter under submission. I will give a little thought to the question of whether there are any issues of fact to be tried.

"There is a possibility that I might deny this motion. I will probably grant it. But let me tell you about your patent.

"If you survive this motion you are in for trouble on this patent, because — this hasn't been argued, but I am almost convinced that apart from prior art, prior specific patents, just in the field of public domain there is almost sufficient to defeat this patent.

"The idea of hosing down the inside of a tank, every kid has used a hose on the inside of a five-gallon oil can, with pressure, to knock substances off. The idea of collecting the material and screening the sand or the scale or the muck out of it is as old as the first pump. The idea of putting a screen in ahead of the pump, the idea of recirculating fluids, particularly fluids that are costly, such as these solvents, is old. The automobile recirculates a fluid through the water pump into the radiator, and



## Exhibit No. 11—(Continued)

it probably has a screen. These ideas out of which you have made this patent are so old that I have serious doubt whether there is any patentability here, even in the combination of them. [24]

“Then when you see the prior art, the thing that startles me is that the Patent Office would issue patents on these matters. The Patent Office has, of course, always granted patents where subsequently they might not be held to be valid. And there is some advantage to the invention in getting a patent with its *prima facie* presumption of validity even though it doesn’t hold up later on. But it is a pretty risky thing to bank on.

“I am not one of these judges that follow the idea of striking down all patents. In fact, you will recall one of the Justices of the Supreme Court said the only patents that are valid are the ones they don’t get their hands on.

“I think I have held as many or more patents that have come before me valid as I have invalid. I think I have probably held more valid than invalid. I believe it is a dangerous thing if we are going to strike down all patents. But this patent really gives me a lot of concern.

“You may get over the hump of this motion, but I think you ought to seriously analyze what you have got here. Probably the commercial success of this company, if there is commercial success, is based upon the solvent that is used, its ability to

## Exhibit No. 11—(Continued)

cut this sealant, based upon its particular method of screening, none of which is claimed in the patent. You don't teach anything about screening. Nobody could take your patent and build the right kind of a screen, because all you say is screening.

“Maybe there is nothing to teach. Maybe it is, again, so old that it wouldn't be of any advantage to teach how you screen it. And it may be that the type of solvent that you use, the way you handle the work, and the way you screen the material out and recycle it has brought about this success. But to say that you are entitled to a patent on a system of hosing down walls, screening out the solvent and repumping it, causes me some concern.

“I will take the matter under submission to see if I can find a triable issue. If there is a triable issue, then you are entitled to have a trial on it. If not, I will grant the motion for summary judgment.”

EXHIBIT No. 12

[Title of District Court and Cause No. 16103-C.]

STIPULATION AND ORDER FOR  
DISMISSAL

It Is Hereby Stipulated by and between the parties to this action, through their respective attorneys, that plaintiff's complaint and defendant's counterclaim may be and the same are hereby dismissed without prejudice and without costs or attorneys fees to either party.

Dated at Los Angeles, California, this 16th day of July, 1954.

MASON & GRAHAM,  
COLLINS MASON,  
WILLIAM R. GRAHAM,  
/s/ By COLLINS MASON,  
Attorneys for Plaintiff-  
Cross-defendant. [25]  
C. G. STRATTON,  
LOUIS M. WELSH,  
Attorneys for Defendant-  
Cross-complainant.

It Is So Ordered this 16th day of July, 1954.

/s/ JAMES M. CARTER,  
United States District Judge.

[Endorsed]: Stipulation and Order for Dismissal. Filed July 16, 1954. Judgment Docketed and Entered July 19, 1954.

[Endorsed]: Affidavit of John M. Lee and Attachments. Filed October 26, 1954.

United States District Court, Southern District  
of California, Central Division

No. 17,387-C Civil

[Title of Cause.]

### MINUTES OF THE COURT

Date: Dec. 13, 1954, at Los Angeles, Calif.

Present: Hon. James M. Carter, District Judge.

Deputy Clerk: L. B. Figg. Reporter: Samuel  
Goldstein.

Counsel for Plaintiff: No appearance.

Counsel for Defendants: C. G. Stratton for def't  
Cee-Bee.

Proceedings: For hearing motion of def't Cee-Bee Chemical Co., Inc., filed Dec. 2, 1954, for leave to amend its answer and counterclaim.

It Is Ordered that said motion is granted, and that the proposed amended answer and counterclaim, lodged with the motion, be filed as the original pleading, and that plaintiff may have twenty (20) days from this date to respond to the counterclaim.

EDMUND L. SMITH,  
Clerk,

By L. B. FIGG,  
Deputy Clerk. [26]

[Title of District Court and Cause.]

AMENDED ANSWER TO COMPLAINT  
AND COUNTERCLAIM

Comes now the defendant, Cee-Bee Chemical Co., Inc., a corporation, and answering for itself alone plaintiff's complaint for declaratory judgment, unfair competition, and relief under the Sherman and Clayton Anti-Trust Laws, admits, denies and alleges as follows:

I.

That the defendant is without knowledge or information sufficient to form a belief as to the truth of the averments of Paragraphs 2 and 5 of the complaint.

II.

(a) Denies that this defendant as agent for defendant Turco Products, Inc., has contended or continues to contend those [27] matters set forth in Sub-paragraph (a) of Paragraph 6, of plaintiff's complaint, and further denies that this defendant has contended or is continuing to contend direct infringement of plaintiff upon said Letters Patent by reason of making or selling said apparatus.

(b) This defendant denies each and every allegation of Sub-paragraph (b) (1) to (7) of Paragraph 6 of said complaint.

III.

Denies each and every allegation of Paragraph 7 of plaintiff's complaint.



## IV.

This defendant is without knowledge or information sufficient to form a belief as to whether the plaintiff owns or enjoys a valuable business or good will in the sale of tank cleaning apparatus for use by its customers or in the sale of chemicals for use by said customers. The defendant denies each and every other allegation contained in Paragraphs 8 through 11 and 14 through 17 in the alleged Second Cause of Action for Unfair Competition. Further answering said second cause of action this defendant denies that plaintiff has been damaged in the sum of Fifty Thousand Dollars (\$50,000.00), in the sum of Twenty-Five Thousand Dollars (\$25,000.00), or in any sum whatsoever by reason of any unlawful acts of this answering defendant.

## V.

The defendant repleads and incorporates herein by reference its answers to Paragraphs 2, 5, 6, and 7 of plaintiff's First Cause of Action.

## VI.

The defendant denies each and every other allegation in the alleged Third Cause of Action under the Sherman and Clayton Anti-Trust Laws. [28]

By Way of Counterclaim Against the Plaintiff, the Defendant Alleges:

## VII.

That the defendant is a California corporation, having its principal place of business in the City of Downey, County of Los Angeles, State of California.

## VIII.

That the defendant alleges that upon information and belief the plaintiff is a Delaware corporation, having its principal place of business in the County of Los Angeles, State of California.

## IX.

That this action arises under the patent laws of the United States, more particularly R.S. § 4919 (35 U.S.C. § 67), as herein more fully appears. Jurisdiction is conferred in this court by 28 U.S.C. § 1338.

## X.

That on September 22, 1953, United States Letters Patent No. 2,653,116 were duly and legally issued to defendant for an invention in Method of Removing Sealant from Fuel Tanks, and since that date defendant has been and still is the owner of said Letters Patent.

## XI.

That ever since said date, plaintiff has been and still is infringing said Letters Patent by practicing said Method, and has been and still is contributing to the infringement of said Letters Patent by making, selling and using, apparatus adapted for, intended for and actually used for the purpose of practicing said Method, all of said acts being within the Southern District of California, and elsewhere in the United States, to the damage of the defendant in the sum of Twenty-Five Thousand Dollars (\$25,000.00). [29]

## XII.

That the defendant has given written notice to plaintiff of its infringement.

Wherefore, defendant prays (a) that the plaintiff's Complaint be dismissed; (b) that judgment be granted against plaintiff in the sum of Twenty-Five Thousand Dollars (\$25,000.00); (c) reasonable attorney fees; and (d) an assessment of costs against plaintiff.

C. G. STRATTON,  
LOUIS M. WELSH,

/s/ By C. G. STRATTON,  
Attorneys for Defendant, Cee-  
Bee Chemical Co., Inc.

Defendant, Cee-Bee Chemical Co., Inc., hereby demands a trial by Jury of all issues triable of right by a jury in this cause of action.

C. G. STRATTON,  
LOUIS M. WELSH,

/s/ By C. G. STRATTON,  
Attorneys for Defendant, Cee-  
Bee Chemical Co., Inc. [30]

Affidavit of Service by Mail Attached. [31]

[Endorsed]: Filed Dec. 13, 1954.

[Title of District Court and Cause.]

ANSWER TO COUNTERCLAIM OF DEFENDANT CEE-BEE CHEMICAL CO., INC.

Comes now the plaintiff Delco Chemicals, Inc. and for answer to counterclaim of defendant Cee-Bee Chemical Co., Inc. admits, denies and alleges as follows:

I.

Admits the allegations contained in Paragraph VII.

II.

Answering Paragraph VIII, admits that plaintiff is a Delaware corporation having its principal place of business in the County of Los Angeles, State of California.

III.

Answering Paragraph IX, admits the allegations contained therein. [32]

IV.

Answering Paragraph X, admits that United States Letters Patent No. 2,653,116 were, on September 22, 1953, issued to the defendant Cee-Bee Chemical Co., Inc. and that it is the owner of said Letters Patent, but denies the balance of the allegations contained in said paragraph.

V.

Answering Paragraph XI, plaintiff denies generally and specifically each and every allegation contained in said paragraph and further denies that the defendant Cee-Bee Chemical Co., Inc. has been

damaged in the sum of \$25,000.00, or in any other sum, or at all.

## VI.

Answering Paragraph XII, plaintiff admits the allegations contained therein.

As an Affirmative Defense to the Counterclaim of Defendant Cee-Bee Chemical Co. Inc. Plaintiff Alleges as Follows:

## VII.

That United States Patent No. 6,253,116 issued on September 22, 1953 for an alleged invention of Keith R. Whitcomb and Eugene E. Finch, was not duly or legally issued, nor does said patent claim or cover that invention, or any inventions; that said patent, and each of the claims thereof, are invalid and void for all the reasons set out in plaintiff's counterclaim for declaratory judgment as fully alleged in Paragraph VI of plaintiff's complaint on file herein.

Wherefore, plaintiff prays judgment that the defendant Cee-Bee Chemical Co., Inc. take nothing by way of relief on its counterclaim against the plaintiff and that judgment be rendered in accordance with the prayer contained in plaintiff's complaint.

FULWIDER, MATTINGLY &  
HUNTLEY & WEYL AND  
WEYL,

/s/ By JOHN A. WEYL,

Attorneys for Plaintiff. [33]

Affidavit of Service by Mail Attached. [34]

[Endorsed]: Filed December 30, 1954.



[Title of District Court and Cause.]

STIPULATION AND ORDER FOR DISMISSAL WITHOUT PREJUDICE OF PLAINTIFF'S SECOND AND THIRD CAUSES OF ACTION

It Is Hereby Stipulated by and between the plaintiff, Delco Chemicals, Inc., and the defendants, Cee-Bee Chemical Co., Inc., and Turco Products, Inc., acting through their respective attorneys of record, that plaintiff may dismiss without prejudice its Second and Third Causes of Action in the above entitled action.

It Is Further Stipulated that an order of dismissal without prejudice may be made upon the basis of this stipulation.

Dated this 2nd day of February, 1955.

FULWIDER, MATTINGLY &  
HUNTLEY AND WEYL AND  
WEYL,

/s/ By JOHN A. WEYL,

Attorneys for Plaintiff.

C. G. STRATTON & LOUIS M.  
WELSH,

/s/ By C. G. STRATTON,

Attorneys for Defendant Cee-Bee  
Chemical Co., Inc. [35]

MASON & GRAHAM AND  
PRESTON & FILES,

/s/ By COLLINS MASON,

Attorneys for Defendant Turco  
Products, Inc.

## Order

Upon reading the foregoing Stipulation and good cause appearing therefrom, it is hereby

Ordered that plaintiff's Second and Third Causes of Action be dismissed without prejudice.

Dated: February 7, 1955.

/s/ JAMES M. CARTER,

District Judge. [36]

[Endorsed]: Filed Feb. 8, 1955. Judgment Docketed and Entered Feb. 8, 1955.

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[Title of District Court and Cause.]

NOTICE OF MOTION AND MOTION FOR  
SUMMARY JUDGMENT

To Cee-Bee Chemical Co., Inc., Defendant Herein,  
and to Its Attorneys C. G. Stratton and Louis  
M. Welsh, Esquires:

You, and Each of You, Will Please Take Notice that on Monday, the 4th day of March, 1957, at the hour of 10:00 o'clock a.m., or as soon thereafter as the matter can be heard, before the above-entitled Court, in the Courthouse and Post Office Building at Spring and Temple Streets, Los Angeles, California, Plaintiff herein will move this Honorable Court for summary judgment, holding United States Letters Patent in suit No. 2,653,116, and all the claims thereof invalid and void.

The grounds for said motion are as follows: [37]

A. The method claimed by the patent in suit is fully and clearly anticipated by prior art which

was not cited or considered by the Commissioner of Patents while the application for the patent was pending and being prosecuted before the United States Patent Office;

B. The method claimed by the patent in suit is devoid of patentable novelty;

C. There does not exist any genuine issue as to material facts necessary to consideration and determination of this motion, since invalidity of the patent in suit is clearly apparent from a comparison of said patent in suit with said prior art which was not considered by the Patent Office but which is before the Court in this motion.

In support of this motion, Plaintiff will rely upon Rule 56 of Federal Rules of Civil Procedure; upon the annexed affidavits of Walter P. Huntley, William V. Koons, and George H. Boeck filed herewith; the affidavit of John M. Lee and attached Exhibits previously filed herein in support of Plaintiff's motion for a preliminary injunction; and upon the following points and authorities:

\* \* \* \* \* [38]

Dated at Los Angeles, California, this 22nd day of February, 1957.

FULWIDER, MATTINGLY &  
HUNTLEY,

ROBERT W. FULWIDER,  
WALTER P. HUNTLEY,  
JOHN M. LEE,  
JOHN A. WEYL,

/s/ By JOHN A. WEYL,

Attorneys for Plaintiff. [41]

[Title of District Court and Cause.]

AFFIDAVIT OF WALTER P. HUNTLEY

State of California,  
County of Los Angeles—ss.

I, Walter P. Huntley, being first duly sworn,  
depose and say

That I am a member of the firm of Fulwider,  
Mattingly & Huntley, attorneys for Plaintiff in the  
above-identified action, and, as such, participated in  
the preparation of the accompanying Motion for  
Summary Judgment, and am familiar with said  
Motion;

That Exhibit A annexed hereto, and by this ref-  
erence made a part hereof, is a true copy of the  
United States Letters Patent in suit No. 2,653,116;

That Exhibit B annexed hereto, and by this ref-  
erence made a part hereof, is a certified copy of the  
file wrapper and contents of said patent in  
suit; [42]

That Exhibit C annexed hereto, and by this ref-  
erence made a part hereof, constitutes true copies  
of the prior patents cited by the United States Pat-  
ent Office against the application for said patent in  
suit, said prior patents being as follows:

Butterworth	Re. 19,374
Foster	1,141,243
Gray	1,628,141
Haupt	1,892,950
McFadden	2,092,321
Paulson et al.	2,123,434

Jaffa	2,442,272
Brady	2,458,333

That attorneys for Plaintiff have caused to be made an independent search of the prior art relating to the subject matter of said patent in suit, and that, as a result of said search, found the following prior patents which are hereunto annexed as Exhibit D, and by this reference made a part hereof, which prior patents were not cited by the United States Patent Office against the application for said Letters Patent in suit:

Butterworth	2,018,757
Butterworth	2,045,752
Land	1,666,015
Jensen	1,730,658
Olsson	2,065,462
Robinson	1,701,824
Court	2,245,554

That attorneys for Plaintiff have caused to be made a further investigation and search for prior publications, other than United States patents, and that as a result of said further investigation, found the below listed documents which by this reference are made a part hereof: [43]

(1) Turco Products, Inc., drawing entitled "Turco Material and Methods for Cleaning Tank Cars" copyrighted 1930, and copyright registered under No. I Pub. 2502, a certified copy of said copyrighted drawing being hereunto annexed as Exhibit E,

(2) The four documents annexed to the affidavit



of William V. Koons as Exhibits F, G, H and I, said affidavit of William V. Koons being hereunto annexed as Exhibit J, and

(3) The three documents annexed to the affidavit of George H. Boeck as Exhibits K, L and M, said affidavit of George H. Boeck being annexed hereto as Exhibit N; and

That concurrently with the filing of this action on October 26, 1954, Plaintiff filed a Motion for a Preliminary Injunction, which motion was accompanied by an affidavit of John M. Lee, which affidavit and the exhibits annexed thereto are herein incorporated by this reference thereto.

/s/ WALTER P. HUNTLEY.

Subscribed and sworn to before me, this 20th day of February, 1957.

[Seal] /s/ MARY WESCOTT,

Notary Public in and for said County and State.

My Commission Expires Nov. 2, 1958. [44]

[Note: The following exhibits are set out in the Book of Exhibits:

Exhibit "A"—K. R. Whitcomb et al Patent 2,653,116 at page 225.

Exhibit "C"—Prior Art Patents Cited by U. S. Patent Office at page 230.

Exhibit "D"—Prior Art Patents Not Cited by U. S. Patent Office at page 271.

Exhibit "E"—Drawing Entitled, "Turco Material and Methods for Cleaning Tank Cars" at page 304.

Exhibit "F"—Certificate of Installation at page 305.]

## EXHIBIT "G"

### Lubrication and Maintenance of the Oakite Interior Tank Cleaning Unit, Model 324.

#### 1. Weekly Lubrication:

Maintain the oil depth to the pet cock level in the speed reducer. Use 600 W oil or equivalent. It is important to check the oil level weekly.

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#### 2. Daily Lubrication:

Use waterproof pump grease for each of the six bearings which are indicated by Alemite fittings. Five of these Alemite fittings are at the lower end of the unit and the sixth fitting is situated under the 18" diameter dome plate.

#### 3. Continual Lubrication:

The Gardner Denver L07 Line Oiler which is furnished with the 324 Unit must be kept filled with a motor oil which will be thin and flow freely at the existing atmospheric temperature. The flow from the oil may be adjusted by removing the top plug and using a special key which comes attached to the oiler. When in operation a slight movement of oil must be observed in the sight feed. Failure to follow these instructions will definitely result in a breakdown of the precision machined internal parts of the air motor.

The Air Motor shaft bearings are automatically lubricated by oil which is discharged from the Air Motor and which drains from a special oil receiver into two lines which feed the bearings.

### Maintenance

When the unit is not to be used for several days discharge a few gallons of cleaning solution through

## Exhibit "G"—(Continued)

it to remove salt or fresh rinse water, thus preventing corrosion.

## Replacement Parts

All of the parts of the equipment have been made of the highest grade of materials obtainable. However, because of the nature of the work which is accomplished, lubrication of several bearing surfaces is dependent upon the cleaning solution. There will be some gradual wear, and replacement parts may be obtained by applying to Oakite Products, Inc., 22 Thames Street, New York, N. Y., or to the Oakite Representative located in the territory where the equipment is being used.

GG:LMD

Revised 12/18/45

A-5748 [51]

## EXHIBIT "H"

Directions for the Installation and Operation of  
the Oakite Interior Tank Cleaning Unit, Model  
324.

Refer to Drawing No. D-463, Sheets 1 and 2.

## General Description:

Sheets 1 and 2 of the Oakite Drawing D-463 show two typical installations of the Oakite Interior Tank Cleaning Unit, Model 324, the equipment having been especially designed for the interior cleaning of all types of tank cars. This work is done whenever it is necessary to change products or periodically to maintain cars which continuously transport the same product. The interior cleaning

## Exhibit "H"—(Continued)

of tank cars is a problem confronted by every owner of this type of equipment and in most instances, the cost of the operation is very high because of the many hours required by laborers to produce satisfactory results by hand methods.

At most plants it is of importance to obtain a definite number of cleaned cars per day. When washed and scrubbed by hand, only a limited number of men can work at one time, resulting in almost daily holding over of cars which should be in service. Such delays are costly, but they can be avoided by the use of the Oakite Interior Tank Cleaning Unit which makes it possible to turn out Very Much Cleaner Cars in a fraction of the former time expended and at an unusually low cost.

In general, the Oakite system is one employing the constant circulation of a hot solution of a heavy duty Oakite cleaning material. This solution is discharged at high pressure from the nozzles of the Model 324 Unit in such a way that thorough cleaning of all interior surfaces is assured; the solution then returning to the heating tank for recirculation. Car cleaning is completed by fresh water rinsing.

The Oakite Interior Tank Cleaning Unit, Model 324, shown hanging over the tank car is operated by a small air motor which causes the nozzles to rotate simultaneously about a vertical and a horizontal axis. During operation the nozzles describe spirals, each turn being very close to the one preceding it and the high pressure stream of solution ejected remove oils and other accumulations, fore-

## Exhibit "H"—(Continued)

ing these deposits away from the surfaces already cleaned. Each square inch of the plates receives the direct impact of one of the sprays every 15 minutes of operation.

We have illustrated two types of installations, the chief difference being in the number of solution and rinse tanks. The two tank system may be employed where a single class of oils is to be continuously removed from cars, whereas the four tank system is required where cars having carried various classes of oil are to be cleaned.

This is true particularly where units are installed by Railroads where both edible and mineral oil cars are maintained. Contamination with mineral oil of a cleaning solution used for cleaning edible oil carrying cars is not permitted and if only two tanks are installed, considerable cleaning solution would have to be discarded and new solutions constantly made up.

## Oakite Cleaning Materials:

Many years of intensive research and innumerable field tests conducted by highly skilled Oakite chemists and engineers has resulted in the development of cleaning materials so compounded as to insure maximum efficiency at the lowest possible cost. A number of these materials, especially Oakite Composition No. 24 have been used daily over a period of over five years for the purpose of cleaning the interior of tank cars. The initial charge of the cleaner in a one thousand gallon tank will



## Exhibit "H"—(Continued)

be from sixty to three hundred pounds, depending upon the type of oil to be removed from cars.

Furthermore, maintaining the proper strength of the solution is accomplished by the addition of only a few pounds of Oakite material per car cleaned and the entire charge, which gradually becomes contaminated, is discarded only after an appreciable number of cars have been cleaned.

It may be stated, without qualification, that the results obtained by the application of Oakite materials are outstanding both as to quality and economy.

## Explanation of Drawing D-463, Sheets 1 and 2.

To show all of the details of construction and installation of equipment would involve many drawings and they would, in most instances, be of little value as local conditions vary so that no two assemblies can be identical. Therefore, the drawing indicates the general scheme, whereas the following description will enable an engineer to make his own detailed plan in accordance with the track and adjacent ground layout.

Sheet #1 indicates an installation comprising two tanks in a concrete lined pit. Other features are the working platform and the single bridge which permits the operator to go over to the car body at the dome where he stands while lowering and fastening the 324 Unit into the car. The drawing indicates a single drain line leading from

## Exhibit "H"—(Continued)

a point directly under the car's correct washing position.

Sheet #2 indicates in installation comprising four solution and rinse tanks and it will be noted that there are two drain lines leading to these tanks. The latter make it possible to utilize two tank car cleaning locations, one on each side of the raised working platform. In this installation there are two bridges for access to car tops and the position of the boom is such that the 324 Unit may be located over either tank car.

Detailed Data On Auxiliary Equipment  
Tank Pit:

We recommend the construction of a concrete lined pit for holding the Oakite cleaning solution and rinse tanks, the solution pump and the various necessary pipe lines. The pit should be of such size as to permit easy access by an operator to all sides of the tanks, and the depth of the pit must be such that the top of the tanks selected for the installation will be at least twenty-four inches below the track which is adjacent to the pit. The pit bottom should be pitched toward a small sump, in which a steam syphon is located. This syphon is used to empty the sump of accumulated water, etc. Convenient stairs or a ladder should extend from ground level down to the floor of the pit and all four sides of the pit should be fitted with a railing to prevent an accidental fall. At many locations, it is found advisable to erect a shed over the pit to exclude cinders, rain, snow, etc.

## Exhibit "H"—(Continued)

## Tanks:

1000 to 1500 gallon Oakite cleaning solution and rinse tanks are used. They may be either rectangular or cylindrical, and should be fitted with hinged covers. They should be constructed of hot rolled plate, all seams being welded. In cases where excessive steam is not available for rapid heating, a 1500 to 2000 gallon rinse tank is used. Then sufficient hot water may be prepared in advance when a car is to be hot rinsed.

In order to minimize the circulation of insoluble materials flushed from cars, each tank which will hold cleaning solution, is partitioned across the middle with a solid sheet steel overflow baffle. This baffle extends from the bottom to within 18 inches of the top of the tank. It is necessary to periodically discard used solution and manually remove accumulated sludge from the solution tank or tanks as the case may be. To accomplish this, there must be a 4" connecting line and valve leading from one side of the tank baffle to the other. This line should be installed about one foot up from the bottom of the compartment into which the solution and sludge first fall after draining from the tank cars. The line then leads into the other compartment at as low a point as possible. Under these conditions, one foot of liquid and insoluble sludge will remain in the first compartment, and the second compartment or half of the tank will be practically emptied when spent solution is pumped out to the sewer. Remaining liquid and sludge

## Exhibit "H"—(Continued)

is then manually removed before recharging the tank with a new Oakite solution. The valve in the above by-pass line will, of course, be opened only when discarding used solution or rinse water.

Some installations will include a fresh hot water rinse tank. The water is not reclaimed for circulation and therefore this tank does not need a center overflow baffle as described above.

Each tank should be fitted with a suitable gauge glass, or if it is found desirable, a single gauge glass may be placed against one of the pit walls. Then lines will lead from the bottom of the gauge glass to each of the tanks and each line will be fitted with a valve. The valves may all be in one location so that the operator can easily note the level in any of the tanks.

Since the time required to clean cars depends a great deal upon the maintenance of proper cleaning solution and rinse water temperatures, it is recommended that each tank be fitted with a reliable boiler type thermometer. Also, and so that the operator can readily check temperatures while the unit is in operation, it is desirable to install a similar thermometer, at a most convenient location, in the discharge line leading up to the working platform.

**Pump Equipment:**

The capacity of the Oakite Interior Tank Cleaning Unit is approximately 100 gallons per minute at 100 lbs. pressure and we, therefore, recommend the use of a 9" x 5 $\frac{1}{4}$ " x 10" steam driven Duplex

## Exhibit "H"—(Continued)

pump or an electrically operated centrifugal pump which has the capacity of 125 gallons per minute against a pressure of 125 lbs. per square inch. The pump obtained for the job should be situated as indicated on the drawing.

As an example of satisfactory pumps we suggest a type V C 9" x 5 $\frac{1}{4}$ " x 10" Worthington Duplex steam pump, which will operate at the desired capacity with a 60 lb. per square inch steam supply, or a #1 $\frac{1}{2}$  D D E 4 two stage close coupled Worthington Centrifugal pump operated by a 20 HP 3600 R.P.M. Motor.

Whether one of the above or a pump of equal capacity manufactured by some other reputable concern is purchased, the order should specify all iron construction, pump to be used for alkaline cleaning solution service and temperature 180° F.

## Working Platform:

A working platform should be erected as shown and it is situated directly adjacent to the boom, the latter being exactly in line with the drain connections. The height of the platform should be the same as that of the top of the body of an average car and a suitable staircase should be erected so as to make it easy for operators to go up and down.

A bridge 24 or 30 inches wide is hinged to the edge of the platform and it should be counter-balanced so that it may be easily lowered toward or raised away from a car. The bridge, platform,



## Exhibit "H"—(Continued)

and stairs should all be furnished with suitable railings so as to prevent accidental falls. The construction of the above equipment may vary considerably and will measurably depend upon local requirements. In most instances, the platform will be built of structural steel and it will be fitted with steel floor grating or wooden planks. Two bridges are erected if cleaning is accomplished on two tracks.

## Boom and Hoist:

A boom and hoist are erected adjacent to the working platform. The outer end of the boom should be directly over the center of the track and approximately 10 feet higher than the top of the average tank car dome. This height permits ample space for the Model No. 324 Unit. As far as actual raising and lowering of the unit is concerned, we recommend the use of a  $\frac{1}{2}$  ton electric hoist which is suspended from the end of the boom. Such a unit is very easily manipulated by means of two conventional pull lines. An alternate to this hoisting method is the use of a counter-balance which can be held within a length of 6 inch pipe. This 6 inch pipe, imbedded in concrete, can be the upright element about which the boom swings or pivots.

## Cleaning Solution and Rinse Lines:

Each solution or rinse tank must be fitted internally at the bottom discharge opening with a large area fine mesh strainer. A cylindrical strainer

## Exhibit "H"—(Continued)

may easily be made up which has an area of not less than 3 sq. ft. of 10 mesh wire. 5 inch suction lines lead from each tank to the intake opening of the pump and each must be fitted with a gate valve. The discharge of the pump is fitted with 3 inch pipe leading to a suitable point on the working platform where it is in turn fitted with a convenient length of 2 inch hose, the latter being attached at its outer end to the intake elbow of the Model 324 Unit.

In the above we stressed the importance of installing thermometers. Of equal importance is the installation of a high grade pressure gauge. This unit may be attached to the discharge line at the same location as the line thermometer. Then the operator will at all times readily know the true operating conditions.

A tee is located in the 3 inch discharge line near the pump and a 3 inch branch line is extended to the main return header. This line and the main solution line are fitted with gate valves. The branch line is utilized only when discarding dirty rinse water or cleaning solution which is of no further value or when transferring solution from one tank to another.

Oakite Products furnishes an easily cleaned large size strainer which must be fitted into the 3 inch solution line at any convenient point between the branch line leading to the sewer and the working platform. We suggest that this strainer be installed 3 or 4 feet above the ground at the

## Exhibit "H"—(Continued)

point where the 3 inch line comes out of the ground and goes up to the platform. This is indicated on the drawings.

The solution hose mentioned above should be carefully fitted with "Boss" or similar couplings so as to prevent any possibility of couplings coming off due to the high pressure at which the solution is maintained in the discharge line. Recovery of the solution which accumulates in the bottom of the car during the operation of the equipment is as follows.

Using the recommended equipment it is necessary to place the car within 12 inches of a marked center line in order to make it easy to couple a length of 5 inch flexible metallic hose to the bottom drain of the car. The drawing shows a 14 foot length of this 5" hose. It is fitted at the pit end with a 5" elbow which points down and is connected loosely by means of a 5" nipple to the top opening of a 6" cross which has been bushed down to 5". The other end of the hose is fitted with a 5" elbow which points up and which is in turn fitted with a 5" x 4" bushing, a close nipple, and a 4" union which has the proper threaded opening for attachment to the drain opening of a car. The union should have two 8 inch long handles welded to it so that it will not be necessary for the operator to use a large wrench in making up the fitting.

Note that we have recommended a 14 ft. length of the 5" metallic hose. The actual straight line distance between the center of the cross and the

## Exhibit "H"—(Continued)

center of the track below the drain opening of the car is 12 feet. Thus the hose will be curved, but at the same time it may be flexed one way or another in order to enable the operator to attach the union to the car. The 6" cross mentioned above is located in the main 6 inch drain line which leads in one direction to the sewer, and to each tank where a 6 inch line continues down to within 2 feet of the bottom of the tank.

During the operation of the equipment, it is often necessary to note the cleanliness of rinse water which is returning from the bottom of the tank car. However, since solid lines lead directly from the bottom of the car down into the tank we recommend that a 1 inch pipe nipple be welded into the 5 inch nipple adjacent to the flexible metallic hose. This nipple is in turn fitted with a 1 inch valve which may be opened from time to time to observe the condition of the returning water.

## Water Lines:

Fresh water rinsing of cleaned cars is accomplished at a pressure of no less than 100 lbs. per square inch and at the rate of about 100 gallons per minute. Therefore a 3" water supply line is preferred. The line may lead directly into a tee situated in the 3 inch solution line which leads from the pump to the working platform. On the other hand, if the water pressure is relatively low, the water line should be led into the suction line of the pump and the latter will then function as a booster. In either case suitable valves must be in-

## Exhibit "H"—(Continued)

stalled so as to permit the circulation of rinse water or cleaning solution, as the case may be. Branch water lines lead to each of the tanks for the purpose of filling them, and another water line leads up to the platform where it is fitted with a 40 ft. length of  $\frac{3}{4}$  inch hose and nozzle which is utilized for hand rinsing of cars which have been cleaned and from which it was necessary to manually remove inert deposits.

## Steam lines:

It is of utmost importance that the Oakite cleaning solution be maintained at a temperature of no less than  $180^{\circ}$  while it is being circulated. In order to maintain this temperature, a suitable coil is fitted into each Oakite solution tank. The size of the coil, of course, depends upon the quality and temperature of the steam available and upon the reduction in temperature of the solution due to its being circulated. As a basis for calculating the size of the coil to be used, we suggest that under normal conditions the temperature drop of the solution from the time it leaves the solution tank to the time it again returns to this tank is  $20^{\circ}$  F. Therefore, approximately 100 gallons or 833 lbs. of solution will be heated  $20^{\circ}$  F. per minute.

The steam coil should be compact; its top pipes being no higher than half the height of the tank and its bottom pipes no lower than 6" from the tank bottom. The steam coil should be contained in the tank compartment from which the solution is drawn by the pump.



## Exhibit "H"—(Continued)

Low pressure steam and condensate discharged from solution heating coils can be led directly into the water contained in the rinse tank. The open end of a second steam line should run down into the rinse water tank. Steam from this line is discharged into the tank to maintain the rinse water temperature at 180°. Additional steam for heating rinse water may be obtained by utilizing the exhaust steam from the pump.

The above mentioned steam lines are not shown on the drawing.

At some points steam may not be available for heating solutions, rinse water or even for operating a duplex pump. Highly efficient oil, or natural or manufactured gas burning equipment may then be obtained. Immersion type burners and automatic thermal control instruments would be installed. Further information on the above may be obtained upon application to the Service Department of Oakite Products, Inc.

Under the above conditions, an electrically operated centrifugal pump such as that recommended under the heading "pumps" would be utilized. Also the pit sump may be fitted with a small electrically operated sump pump.

**Air Lines:**

In order to insure rapid draining of solution from cars, we recommend the use of high pressure air which should be conducted by means of a 1 inch

## Exhibit "H"—(Continued)

pipe terminating at a 1" Globe valve. This Globe valve is located at one side of the overhead platform and is connected by means of hose which extends to the  $\frac{3}{4}$ " pipe outlet which is situated on the top of the 324 Unit. Utilizing compressed air eliminates also the development of a vacuum when a heated car is rinsed with cold water. At the platform location, a branch line is extended from the above 1" air line. This branch is fitted with a pressure regulating valve which is adjusted for correct motor speed, a Globe valve, the LO7 Gardner-Denver Oiler and the special brass oil sight feed. The latter is fitted with a convenient length of  $\frac{1}{2}$ " hose which leads to the air motor. The oiler and the sight feed are furnished by Oakite Products and their continued use and careful maintenance is imperative. If a small amount of oil is not constantly carried along with the air, the very finely machined surfaces within the air motor will immediately score and the motor will cease to function.

A 15 H.P. compressor such as the Ingersoll Rand Unit #15 B Type 40 complete with Belt, Base and Receiver, will furnish sufficient high pressure air to operate the motor of the Model 324 Unit and to maintain the pressure with a car being cleaned at 5 lbs.

## Drain Lines to Sewer:

Each solution and rinse tank should be fitted with a 6 inch overflow line leading from a point approximately 6 inches below the top to the sewer.

The main solution return line was described in

## Exhibit "H"—(Continued)

the above, and we mentioned the use of a 6 inch cross. A 6 inch drain line fitted with a gate valve leads from this cross to the sewer. Another line which leads to the sewer, and which has also been mentioned in the above, is that which carries rinse water or cleaning solution to be discarded from the discharge line which extends from the pump.

Another line which may lead to the sewer is that which extends out of the pit and which starts down at the pit sump, steam syphon or sump pump.

## Warning—Safety Device:

To Avoid Any Possibility of the Development of Static Electricity We Recommend the Use of a Flexible Ground Cable Which Can Be Obtained Locally. One End of the Cable Should Be Permanently Fastened to a Clean Metal Surface of the 324 Unit. It Is of Greatest Importance That the Other End of the Above Cable Be Perfectly Grounded, Before Solution or Water Is Pumped. The Above Cable and Fittings Are to Be Furnished by the Customers.

## Directions For Cleaning Cars

## General:

While the procedure of cleaning tank cars varies somewhat depending upon the type of oil to be removed, there are several operations which are carried out on all cars. These are presented before taking up the details of the removal of several operations which are carried out on all cars. These

## Exhibit "H"—(Continued)

pipe terminating at a 1" Globe valve. This Globe valve is located at one side of the overhead platform and is connected by means of hose which extends to the  $\frac{3}{4}$ " pipe outlet which is situated on the top of the 324 Unit. Utilizing compressed air eliminates also the development of a vacuum when a heated car is rinsed with cold water. At the platform location, a branch line is extended from the above 1" air line. This branch is fitted with a pressure regulating valve which is adjusted for correct motor speed, a Globe valve, the LO7 Gardner-Denver Oiler and the special brass oil sight feed. The latter is fitted with a convenient length of  $\frac{1}{2}$ " hose which leads to the air motor. The oiler and the sight feed are furnished by Oakite Products and their continued use and careful maintenance is imperative. If a small amount of oil is not constantly carried along with the air, the very finely machined surfaces within the air motor will immediately score and the motor will cease to function.

A 15 H.P. compressor such as the Ingersoll Rand Unit #15 B Type 40 complete with Belt, Base and Receiver, will furnish sufficient high pressure air to operate the motor of the Model 324 Unit and to maintain the pressure with a car being cleaned at 5 lbs.

## Drain Lines to Sewer:

Each solution and rinse tank should be fitted with a 6 inch overflow line leading from a point approximately 6 inches below the top to the sewer.

The main solution return line was described in

## Exhibit "H"—(Continued)

the above, and we mentioned the use of a 6 inch cross. A 6 inch drain line fitted with a gate valve leads from this cross to the sewer. Another line which leads to the sewer, and which has also been mentioned in the above, is that which carries rinse water or cleaning solution to be discarded from the discharge line which extends from the pump.

Another line which may lead to the sewer is that which extends out of the pit and which starts down at the pit sump, steam syphon or sump pump.

## Warning—Safety Device:

To Avoid Any Possibility of the Development of Static Electricity We Recommend the Use of a Flexible Ground Cable Which Can Be Obtained Locally. One End of the Cable Should Be Permanently Fastened to a Clean Metal Surface of the 324 Unit. It Is of Greatest Importance That the Other End of the Above Cable Be Perfectly Grounded, Before Solution or Water Is Pumped. The Above Cable and Fittings Are to Be Furnished by the Customers.

## Directions For Cleaning Cars

## General:

While the procedure of cleaning tank cars varies somewhat depending upon the type of oil to be removed, there are several operations which are carried out on all cars. These are presented before taking up the details of the removal of several operations which are carried out on all cars. These



## Exhibit "H"—(Continued)

are presented before taking up the details of several kinds of oils.

After the car to be cleaned has been placed in the proper position, the dome cover is removed and the Model 324 Unit lowered into position. The hand clamps are turned to the proper angle and tightened to prevent any leakage of solution. The copper ground cable should now be fastened to the car by means of a hand clamp.

Then the 5" flexible steel pipe which has been resting alongside of the track is swung into position and coupled to the car within.

The Red Rubber Indicator Located On Top of the Speed Reducer Should Not be Permitted to Turn More Than 30 R.P.M. At this speed every internal surface of the car will receive the direct impact of a stream of solution during a 15 minute run. If when air is admitted to the air motor and the latter does not turn, revolve the hand wheel a half turn by hand. Occasionally the motor will stop on a dead center.

It is of utmost importance to maintain the solution pressure and temperature to the degree required to obtain best results. We usually recommend an operating pressure of 100 lbs. and solution temperatures of 180° F. Under these conditions approximately 100 gallons of solution are circulated per minute.

High pressure air is admitted into the car dur-

## Exhibit "H"—(Continued)

ing the cleaning and rinsing operations to hasten draining and to minimize the depth of the solution or water on the car bottom. Thus the bottom plates will be properly cleaned by the action of the high pressure streams discharged from the nozzles, except as described hereafter. If too high an air pressure is built up within the car the air will blow down through the drain opening. Therefore, we recommend that the depth of the solution be maintained at approximately 4". After initial trial this depth can be ascertained by examining the drop in solution level in the solution heating tank.

A gauge made of a piece of 2" x 3" timber may be clamped to the tank so that it extends in a vertical position a foot or so above the solution level. The wood is graduated with deep notches to show the depth of the Oakite solution in the car. If desired, float gauges may be installed.

Cold water rinsing of a heated car creates a partial vacuum. High pressure air, admitted during this operation, breaks the vacuum and makes it possible for the rinse water to drain properly.

While hot water rinsing may be carried out for any length of time, it is important not to rinse very long with cold water. All that is required of this operation is to lower the car temperature to a degree where it is possible for an operator to enter the car. If cooled too much with cold water, the subsequent drying of the car interior will take considerably longer than otherwise necessary.

## Exhibit "H"—(Continued)

After cars have been cleaned with the Model 324 Unit, a small amount of residue may remain at the ends. This deposit is removed manually in a short time after which the operator utilizes the hand rinse hose for a final flushing out.

When it is desired to clean the interior of the tank car coils proceed as follows. A one inch hose is led from a fitting on the pump discharge line to the intake of the tank car coil. The solution should be circulated through the coils and returned to the Oakite tank. It is important that no more than 10 G.P.M. be circulated through the coils, otherwise too much solution will be diverted from the unit resulting in decreased pressure and less effective cleaning.

## Charging The Solution Tank:

Admit water to one-third of the normal working level and while this water is being heated, slowly add the charge of Oakite material which will result in the correct concentration of the full amount of solution. Boil thoroughly for several hours before adding the balance of the water.

## Upkeeping The Solution Strength:

Keep strength of the Oakite solution up to the required concentration at all times. This is done by adding the proper amount of Oakite to each tank at the end of each day.

## Charging The Hot Rinse Tank:

Fill to operating level with fresh water and keep at 180° F. or higher during rinsing operation.

## Exhibit "H"—(Continued)

As mentioned above, the cleaning method varies somewhat depending upon the type of oil carried. The following gives a general idea of the time intervals and sequence of operations when cleaning cars having held various kinds of oils.

## Gasoline Cars:

1. Hot water rinse 180° F. (not circulated, but run to sewer) to remove gasoline from car bottom, for 10 minutes.
2. Circulate Oakite Composition No. 24 solution, 2 to 5 oz./gal. at 200° F. and 100 lbs. pressure, for 1 hour.
3. Hot water (circulating) rinse at 180° F. and 100 lbs. pressure for 15 minutes.
4. Cold water rinse until car may be entered by an operator who will remove insoluble soils and rust. Car must remain as hot as possible so as to facilitate final drying.

## Lubricating and Light Oil Cars:

1. Circulate Oakite Composition No. 24 solution, 5 ounces per gallon at 200° F. 100 lbs. pressure, for from 1/2 to 1 hour.
2. Hot water (circulating) rinse at 180° F. and 100 lbs. pressure for 15 minutes.
3. Cold water rinse as above.

## Fuel Oil Cars:

1. Hot water (circulating) rinse at 180° F. and 100 lbs. pressure to remove excess oil. This oil will

## Exhibit "H"—(Continued)

float on top of the rinse water in the hot rinse tank, and is removed by overflowing into the sewer.

2. Circulate Oakite Composition No. 24 solution, 5 ounces per gallon at 200° F. and 100 lbs. pressure, for from 1 to 3 hours depending upon the grade of oil.

3. Hot water (circulating) rinse at 180° F. and 100 lbs. pressure for 15 minutes.

4. Cold water rinse as above.

## Crude Oil Cars:

1. Steam cars as long as expedient to condition car for second operation.

2. Hot water (circulating) rinse at 200° F. and 100 lbs. pressure until oil no longer drains from car.

3. Circulate Oakite Composition No. 24 solution, 5 ounces per gallon at 200° F. and 100 lbs. pressure, for from 2 to 4 hours.

4. Hot water (circulating) rinse at 200° F. and 100 lbs. pressure for 30 minutes.

5. Cold water rinse as above.

## Asphalt Cars:

1. Steam cars for 20 to 24 hours prior to the following operations.

2. Hot water (circulating) rinse at at least 180° F., preferably 200° F. and 100 lbs. pressure until asphalt no longer drains from car.

3. Circulate Oakite Composition No. 24 solution, 5 ounces per gallon at 200° F. and 100 lbs. pressure from 5 to 10 hours.



Exhibit "H"—(Continued)

4. Hot water (circulating) rinse at 200° F. and 100 lbs. pressure for 30 minutes.
5. Cold water rinse as above.

Fish and Edible Oil Cars:

1. Hot water rinse 180° F. (circulated) continue until all excess oil is removed from the bottom of the car.
2. Circulate Oakite Composition No. 24 solution, 1 to 2 ounces per gallon, at 200° F. and 100 lbs. pressure, for from 1½ to 1½ hours.
3. Hot water (circulating) rinse at 180° F. and 100 lbs. pressure for 15 minutes.
4. Cold water rinse as above.

Important Information Regarding Lubrication and Maintenance:

Directions in duplicate entitled Lubrication and Maintenance of the Oakite Interior Tank Cleaning Unit, Model 324 are attached. It is suggested that one set be framed and mounted in a conspicuous position at the car cleaning installation. Oakite Products, Inc., assumes no responsibility should a motor be destroyed due to lack of lubrication. Like any other machine failure to lubricate the moving parts as set forth in the directions for oiling and greasing, will surely result in very greatly lessening the life of the Model 324 Unit.

Name Plate:

We have had an attractive porcelain enamel sign 10" x 15" made up which reads as follows:

Exhibit "H"—(Continued)

OAKITE

INTERIOR TANK

CLEANING SYSTEM

Designed and Serviced By

Oakite Products, Inc.

22 Thames St., New York, N. Y.

One of these signs is included in the shipment of each 324 Unit and we will appreciate its being mounted in a conspicuous place such as one of the columns which support the overhead working platform.

All of the above data regarding the Oakite Interior Tank Cleaning Unit, its installation, maintenance and operation is necessarily general. Further and more detailed information will be presented by the Oakite Representative who will be at hand to give his personal attention to the installation and initial cleaning of cars.

Before the customer starts actual construction, we strongly recommend that preliminary pencil sketches or blueprints of tanks, steam coil construction, etc. be forwarded to the Service Dept. of Oakite Products, Inc., in New York. These prints will be checked and returned to the customer with any suggested changes clearly marked on the print.

Oakite Products, Inc.

General Offices

22 Thames Street, New York 6, New York

GG:MGH

Revised 4/3/46

A-5921 [52]

[Exhibit I—Drawing entitled “Oakite Interior Tank Cleaning—Unit Model 324—4 Tank Installation” is set out in the Book of Exhibits at page 306.]

EXHIBIT “J”

[Title of District Court and Cause.]

AFFIDAVIT OF WILLIAM V. KOONS

State of California,  
County of Los Angeles—ss.

I, William V. Koons, being first duly sworn and testifying to facts within my own personal knowledge, depose and say:

That I am a private investigator, and was, prior to November 28, 1956, engaged by Fulwider, Mattingly & Huntley, attorneys for Plaintiff herein, to investigate the Oakite Interior Tank Cleaning System used by the Southern Pacific Company in Los Angeles;

That on November 28, 1956, with the consent and permission of the Southern Pacific Company, I obtained from the files of the Chief Draftsman at the general shops, 1800 Alhambra Avenue, the following documents:

(a) One-page document dated February 5, 1948, entitled “Certificate of Installation”, a copy of [54] which is hereunto annexed as Exhibit F, and by this reference made a part hereof,

(b) One-page document dated “Revised 12/18/45” entitled “Lubrication and Maintenance of the

## Exhibit "J"—(Continued)

Oakite Interior Tank Cleaning Unit, Model 324", a copy of which is hereunto annexed as Exhibit G, and by this reference made a part hereof,

(c) Eleven-page document dated "Revised 4/3/46" entitled "Directions for the Installation and Operation of the Oakite Interior Tank Cleaning Unit, Model 324", a copy of which is hereunto annexed as Exhibit H, and by this reference made a part hereof, and

(d) Drawing dated March 25, 1945, entitled "Oakite Interior Tank Cleaning—Unit Model 324—4 Tank Installation" and bearing the designation "Drawing No. D463-S2", an enlarged copy of which is hereunto annexed as Exhibit I, and by this reference made a part hereof;

That I caused photostatic reproductions to be made of said documents, and then returned the original documents to the Southern Pacific Company;

That Exhibits F, G, and H are true and correct copies of the original documents aforesaid; and

That Exhibit I is a true and correct copy of the drawing which I obtained from the Southern Pacific Company, as aforesaid, but differs therefrom in the single respect that it is an enlargement of the original.

/s/ WILLIAM V. KOONS.

Subscribed and sworn to before me this 20th day of February, 1957.

[Seal] /s/ MARY WESCOTT,

Notary Public in and for said County and State.

My Commission Expires Nov. 2, 1958.

[Exhibit "K"—Drawing No. D-463-S1 set out at page 307. Exhibit "L"—Drawing No. D463-S2 set out at page 308, and Exhibit "M"—Drawing No. C-222 set out at page 309 of the Book of Exhibits.]

EXHIBIT "N"

[Title of District Court and Cause.]

AFFIDAVIT OF GEORGE H. BOECK

State of California,  
County of Los Angeles—ss.

I, the undersigned, George H. Boeck, being first duly sworn and testifying to facts within my own personal knowledge, depose and say:

I am 56 years of age and have been employed by Oakite Products, Inc., of New York (hereinafter referred to as "Oakite") continuously since 1924, and I am presently employed by Oakite as Technical Service Representative, which position I have held since 1924;

That Oakite Drawings Nos. D463-S1 and D463-S2, copies of which are attached hereto as Exhibits K and L, respectively, and by this reference made a part hereof, were prepared by an Oakite [58] draftsman in 1945, on or before the dates appearing on said Exhibits, (to-wit: September 4, 1945 and March 25, 1945), Exhibit L was based upon and reproduced original design sketches which I made in 1944;

That said drawings, Exhibits K and L, were re-



## Exhibit "N"—(Continued)

produced by Oakite in quantity and furnished to me and to other Oakite representatives and were, by me and by said other representative, prior to March 16, 1948, given to many customers and prospective customers of Oakite throughout the United States who were using or who were interested in the Interior Tank Cleaning System illustrated thereby;

That I have read the affidavit of William V. Koons executed February 20, 1957, relating to the captioned matter and have carefully examined the exhibits thereunto annexed;

That I recognized Exhibits G and H annexed to said affidavit of William V. Koons as copies of lubrication and maintenance instructions and installation and operating directions which I had delivered to Southern Pacific Company in Los Angeles prior to March 16, 1948;

That between the dates which said Exhibits G and H bear, (to-wit: December 18, 1945, and April 3, 1946) and March 16, 1948, copies of said Exhibits G and H were, by me and by other Oakite representatives, distributed to many customers and prospective customers of Oakite throughout the United States who were using or were interested in the Oakite Interior Tank Cleaning Unit Model 324;

That I recognize Exhibit I annexed to said affidavit of William V. Koons as an enlarged copy of Oakite Drawing No. D463-S2, (another copy of which is hereunto annexed as Exhibit L, as afore-

Exhibit "N"—(Continued)

said) which I delivered to the Southern Pacific Company in Los Angeles, prior to March 16, 1948; and

That Oakite Drawing No. C222, a copy of which is attached hereto as Exhibit M, and by this reference made a part hereof, was reproduced by Oakite in quantity and furnished to me and to other Oakite representatives and were, by me and by said other representatives long prior to March 16, 1948, given to many customers and prospective customers of Oakite throughout the United States who were using or who were interested in the Inside Drum Cleaning Equipment illustrated thereby.

/s/ GEORGE H. BOECK.

Subscribed and sworn to before me this 20th day of February, 1957.

[Seal] /s/ HELEN J. SULLIVAN,  
Notary Public in and for said County and State.

My Commission Expires Sept. 6, 1960.

[Endorsed]: Filed February 25, 1957.

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[Title of District Court and Cause.]

DEFENDANT'S NOTICE RE PLAINTIFF'S  
MOTION FOR SUMMARY JUDGMENT

To the above-named plaintiff, and to Fulwider,  
Mattingly & Huntley, Esqs., and John A. Weyl,  
Esq., its attorneys, Greetings:

Please Take Notice that at the hearing on the

plaintiff's Motion for Summary Judgment in the above case, the defendant will rely upon the annexed affidavits of Edward W. Giddings, Keith R. Whitecomb, William Douglas Sellers, James L. Jackson, Claud D. Black and Vesta M. Nelson, upon the annexed Certificate of Arthur Fisher, Register of Copyrights, upon the depositions of Robert C. Baer, Charles R. Ursell, Thomas H. Edgin, Sydney G. Thornbury and Archy F. Slover, filed herein, upon the annexed Reporter's Transcript of [96] Proceedings in the case of Taylor v. Keuffel & Esser Co., No. 15,820-WM, and upon the Complaint, Answer and Counterclaim, and Answer to Counterclaim, in the above case.

Dated at Los Angeles, California, this 1st day of April, 1957.

C. G. STRATTON,  
LOUIS M. WELSH,

/s/ By C. G. STRATTON,  
Attorneys for Defendant. [97]

### AFFIDAVIT OF EDWARD W. GIDDINGS

State of California,  
County of Los Angeles—ss.

Edward W. Giddings, of the aforesaid County and State, being first duly sworn, on oath deposes and says that he is Vice President in Charge of Sales and Engineering of the Cee-Bee Chemical Co., Inc., which is the defendant in the case of Delco Chemicals, Inc. v. Cee-Bee Chemical Co., Inc., No. 17,387-WM, in the District Court of the

United States, for the Southern District of California, Central Division, involving United States Letters Patent No. 2,653,116, hereinafter called the patent in suit, and he gives the following affidavit from his own personal knowledge:

That affiant has been in charge of sales and engineering of said defendant for fifteen (15) years, and in such capacity has traveled many times to airports in all parts of the United States, where desealing of aircraft fuel tanks is carried on. Part of his job is to study the different methods of desealing such tanks and learn the results thereof. Affiant also has personal knowledge of the developments in the aircraft desealing field, which led up to the method covered by the patent in suit.

That a C-54 or a DC-4 airplane costs in the neighborhood of one-half to three quarters of a million dollars (\$500,000 to \$750,000), and a DC-6 or a Constellation costs one and one-half to two million dollars (\$1,500,000 to \$2,000,000), so that they are very valuable mechanisms. All such aircraft are so built that the tips of the wings flex several feet under stresses of landing, taking off and flying under stormy conditions. When the sealant in the integral fuel tanks in the wings of such aircraft gets older and hardens, such flexing cracks the hardened sealant and/or breaks it away from the seams, rivets, bolts or nuts inside the metal fuel tank. Then the sealant has to be removed and fresh sealant placed over all seams and completely cover [98] all rivets, nuts and bolts within the fuel tank.

The first method of removing the sealant was by

“hand picking.” The workmen had to be dressed in “Men-from-Mars” suits and had to be supplied with oxygen through hoses, in order to protect them from the gasoline fumes and scarcity of oxygen in the tanks. In these cumbersome suits, they crawled into the cramped quarters of the wing tanks of aircraft, often only ten or eleven inches high, and while lying down laboriously chiseled out the hardened synthetic-rubber-compound sealant, fragment by fragment. This took weeks of time because only one workman could reach a given area at one time, or only one workman could be in the relatively small tank at one time. This was not only expensive for workmen’s time, but ground time for the average plane is considered as costing about \$4,000.00 per day.

Because of the difficulties of working under such adverse conditions, and because of the great expense of this method, a new desealing method was sought. That I was constantly in touch with engineers in charge of such desealing operations in all parts of the United States throughout the period that such hand-picking method was being generally used. That although the patents, cited by the plaintiff in said suit, describing the cleaning of tank cars and ships, were on file in the Patent Office during the period that the aircraft industry was experiencing such difficulties with the said hand-picking method, the problem remained unsolved until the method of the patent in suit was invented.

That I believe such tank car and ship cleaning methods did not suggest themselves to the engineers



skilled in the desealing art for several reasons. In the first place, removing oil or asphalt from a tank car or scale from the hull of a ship is a conventional cleaning operation. The oil, asphalt or scale were not intended to be and were not normally part of the tank or ship, and [99] they are removed as foreign substances as soon as possible. Sealant is a normal, permanent part that is built right into the aircraft, and removing it is a step in a repairing method, for new sealant is replaced in the fuel tank as soon as the old sealant is removed. In a sense, the methods are exactly opposite. An aircraft cannot be flown without the sealant; it is an integral part of the aircraft. The oily or asphalt residue or scale are detriments to the tank car or ship and should be removed, the sooner the better.

Secondly, and probably more important, no tank car or ship had to have a synthetic-rubber compound removed, which is in the nature of aircraft fuel tank sealants. The solvent used to remove same dissolves the sealant in time, except that the cover coat normally remains a sticky, gummy substance when swollen with the solvent and has almost the same specific gravity as the desealing material. That because of the relative rapid flow of the desealing material and the lightness in weight of such sticky, gummy, swollen sealant cover coat, the latter will not settle behind a weir and will not settle in the solvent reservoir used by either party to said action. That, therefore, a reservoir such as used by the parties hereto cannot and does not act as a settling or clarifying chamber. Since neither the tank car nor

ship cleaning processes would be operative for removing sealant, it is no wonder that such processes offered no suggestion to those in the industry trying to solve the aircraft sealant-removing problem.

The next method tried was the fill-soak-and-drain method, whereby the aircraft fuel tank was filled to the top with the desealing material, permitting the sealant to soak for weeks and then the solvent was drained out with most of the sealant. Then the workmen had to crawl in, dressed in "Men-from-Mars" suits, and supplied with air hoses in order to protect them from the highly toxic and often inflammable desealing fumes, and chisel out what always remained after such soaking. Such a "Man-from-Mars" suit [100] is shown in annexed Exhibit 1. The material used in many desealing processes is inflammable; in fact, one workman on a Capitol Airlines plane in Washington, D. C., was burned to death when such desealing material caught fire. That often desealing material is highly acidic and can cause third-degree burns and can put out an eye by direct contact.

The fill-soak-and-drain method was also time-consuming and very expensive. The fill-soak-and-drain method took 1200 man hours, about two weeks of ground time, and 3,000 gallons of expensive solvent costing about \$3.00 per gallon, for a C-54 or DC-4 plane.

With the industry in this condition, the method of the patent in suit was invented. By it, a direct spray of strong desealing material is directed against the sealant. The tank is at all time filled

with the volatile vapors from the solvent. These fine vapors penetrate pores of the sealant that are too small for the spray to enter. This process, as well as the problems which it solved, is different from those involved in cleaning the residue of cargoes or scale that remains on the walls of tank cars or ship tanks. The solvent is a strong, toxic material that is injurious to personnel. By long, continued spraying the sealant is dissolved except for the sealant cover coat, which is not normally dissolved but becomes a sticky, gummy substance in the liquid solvent. This gradual dissolution of the body of the sealant and washing away of the sealant cover coat in gummy pieces, strips or chunks take many hours. In neither a tank car nor a ship is there anything known to affiant that is comparable to the mixture of the toxic solvent and the non-dissolved sealant cover coat of synthetic-rubber compound that is a sticky, gummy substance. As a great improvement over previous processes used in this field, water can be substituted for the desealing material, before the fuel tank is opened, to wash away the volatile, toxic, acidic fumes.

That affiant is familiar with the method of the patent in [101] suit since it is his business to sell chemicals for use in said method, and to supervise actual desealing operations employing the patented method. That the method of the patent in suit is quicker and far less expensive in man hours, gallons of solvent and ground time than the next best fill-soak-and-drain method. Said patented method will desal a C-54 or DC-4 plane with 500 man

hours of labor, 600 gallons of solvent and five days' ground time. In other words, the saving effected by the patented method in an average desealing job on a C-54 or DC-4, as compared with any previous fill-and-soak-and-drain method, is about \$18,700.00, and the total saving to the United States Government by reason of the use of the patented method, over the said previous method, conservatively averages \$2,000,000.00 per year, making a total saving to the government beginning in 1950, by the use of the patented method, of conservatively over \$12,000,000.00!

That prior to the commercial introduction of the method of the patent in suit, it was not commercially feasible to deseal an airplane, because of the expense hereinbefore related. When the fill-soak-and-drain method was being used generally, practically the only desealing that was done was by the government, which did not need to be too concerned with expense. The only commercial aircraft that were desealed during the fill-soak-and-drain period were those that would have had to have been abandoned if they had not been desealed. In such days, commercial planes often flew that were not safe. Today, because of the patented method, desealing is required and is commercial practical.

That the method of the patent in suit has a great military advantage. The loss of ground time for desealing military aircraft is not so much a matter of loss of money as it is exposure to danger in time of national peril. At such time, it is of extreme importance to get the planes back in the air in the



least possible time. The patented process does this. [102]

That for the reasons given herein the method of the patent in suit filled a long-felt need in the industry for a process that would be quicker, less expensive and less hazardous to personnel.

Even though Land Patent No. 1,666,015 was issued by the Patent Office almost 29 years ago, and the Turco Products, Inc. drawing (plaintiff's Exhibit B herein) was copyrighted in 1930, it apparently took more than the skill of the thousands of mechanics skilled in this industry to attempt to apply them to the present problem.

In fact, the first reaction stated to the undersigned by mechanics in the field, upon hearing of the method now covered by the patent in suit, was that the relatively hard, synthetic-rubber-compound sealant could not be removed by a mere spray, because it took a week or two of constant soaking to loosen and remove it. Another objection, heard by affiant, to the patented method when first introduced by the defendant was that it would be more injurious to personnel than the previous fill-soak-and-drain method because of the spraying of the solvent. These objections proved incorrect, but they were given as reasons why it was thought the recirculating spray method would not operate satisfactorily.

However, the patented method has been or is now in use in Pan American Airways, Brownsville, Texas, and Miami, Florida; United Airlines, South San Francisco, California; American Airlines,



Tulsa, Oklahoma; Capitol Airlines, Washington, D. C.; Twentieth Century Airlines, Burbank, California; Slick Airways, Burbank, California; Flying Tigers, Burbank, California; Colonial Airlines, New York, New York; Long Beach Airmotive, Long Beach, California; Douglas Aircraft Co., Long Beach and Santa Monica Division; United States Naval Air Stations at Sand Point, Seattle, Washington, and Pensacola, Florida; Civil Aeronautics [103] Authority, Oklahoma City, Oklahoma; Kelly Air Force Base, San Antonio, Texas; Pacific Airmotive Corp., Chino, California; and Norton Air Force Base, San Bernardino, California.

While it is believed that this list of the users of the patented process is quite persuasive that invention is involved in the patented method, it is thought that it is also very striking to note that Turco Products, Inc. had said copyright from 1930 on, and was licensee under the said Land patent for many years, and practically up to the time that the defendant introduced the patented method in the industry, but Turco Products, Inc., one of the leaders in the chemical industry, not only did not make any use of the Land patent whatever in the desealing of aircraft, until after they saw the defendant's use of the method of the patent in suit, but prior thereto representatives of said Turco Products, Inc. stated that the patented process would not work, and that if the patented process were any good, "Turco would come out with it." Now Turco Products, Inc. is a licensee under the patent in suit.

That the annexed Exhibit 2 is a photograph showing one of the plaintiff's desealing machines when connected and ready for operation.

That the annexed Exhibit 3 is a print of a photo showing one of the defendant's desealing units connected and in the act of desealing an integral aircraft fuel tank.

That Exhibit 4 is a close-up view of the defendant's desealing unit underneath an aircraft wing showing the spray pipe with its spray nozzles underneath the wing, and with hatches removed from the underside of the aircraft wing, showing the inside of the wing tank.

That Exhibit 5 is a photo print showing defendant's desealing unit connected to an integral aircraft fuel tank during the desealing operation thereof.

That Exhibit 6 shows a panel upon which mounds of sealants [104] of different kinds have been placed.

That Exhibit 7 is a jar of solvent, such as used in removing sealants from integral aircraft fuel tanks.

That Exhibit 8 is a jar of dried sealant which originally was in an integral aircraft fuel tank but which has been removed by the patented process, and dried.

That in 1952, Air Force personnel at the Tinker Air Force Base, Oklahoma City, Oklahoma, published an evaluation report giving advantages (among others not pertinent to the present case) of the method described in the patent in suit, over the

previously used fill-soak-and-drain method, to wit:  
Automatic filtering unit incorporated in machine.  
Spray nozzles concentrated at corners and fittings.

Positive check on all spray nozzles during operation.

Absence of fumes in whole hangar.

Toxicity and hazards are minimized.

No need for transferring large quantities of material.

No need for large storage and inventory.

Workmen do not come in direct contact with stripper [solvent].

Desealing machine is portable and self contained.  
Actual stripping time is reduced.

The need for spray or stripper on brush is minimized.

No need for fill and drain.

With present facilities, twice as many tanks can be stripped with one unit. [105]

Permits inspection of stripper process during operation.

Less damage to tank due to hand picking.

Small quantity of material required for operation.

High-pressure rinse can be done simultaneously with desealing operation.

That the above list of advantages was compiled from tests made on a C-54 aircraft in which the patented method was compared with the fill-soak-and-drain method. That the above list correctly states advantages of the patented method over the

previous fill-soak-and-drain method, although the above list included technical advantages only; the cost advantages of the recirculating spray method over the fill-soak-and-drain method were separately noted.

/s/ EDWARD W. GIDDINGS.

Subscribed and sworn to before me this 29th day of March, 1957.

[Seal] W. W. DUFRESNE,  
Notary Public in and for the County of Los Angeles, State of California. My Commission expires May 6, 1960. [106]

### AFFIDAVIT OF KEITH R. WHITCOMB

State of California,  
County of Los Angeles—ss.

Keith R. Whitcomb, of the aforesaid County and State, being first duly sworn, on oath deposes and says that he is one of the inventors named in United States Letters Patent No. 2,653,116, the patent in suit in the case of Delco Chemicals, Inc. v. Cee-Bee Chemical Co., Inc., No. 17,387-WM, in the District Court of the United States, for the Southern District of California, Central Division, and he gives the following affidavit from his personal knowledge:

That affiant is a research chemist in the employ of the above-named defendant, and has been continuously so employed since September, 1946, and since 1948 has been Technical Director for said defendant; and in such capacity has been in charge

of the chemical and testing laboratory of the said defendant ever since its beginning in September, 1946. At the present time, affiant has five other employees of said defendant under his supervision in said laboratory. That affiant is a graduate of San Diego State College in the year 1940, with the degree of A.B. with chemistry major, and received a degree of M.A. with a chemistry major in 1942 from Claremont College, the graduate school of Pomona College.

That affiant has been continuously employed as a chemist ever since receiving his Master's degree in June, 1942. That he was employed by Ryan Aeronautical Co., San Diego, in their chemical laboratory from June, 1942, to November, 1944, and was in charge of production research for that company for almost two years of that period. Also during that period, affiant developed and invented a welding flux for stainless steel that is still being used by that company. He also developed and invented a salt-bath heat treating process for stainless steel that was in use by that company for about two years, and developed and invented a [112] brazing alloy for brazing stainless steel to provide a high temperature surface, which was patented. From November, 1944, to April, 1946, affiant was Laboratory Officer in Charge of Materiels (Chemical) Laboratory at El Toro Marine Base, Santa Ana, California. From April to September, 1946, he was again employed by Ryan Aeronautical Co., and then came to the defendant.

That the suggestion for using the spaces in the



wings of aircraft for integral fuel tanks first occurred at least as early as 1937 or 1938. However, in order to use these spaces as fuel tanks, it was necessary to put some type of sealant within the tank to cover the seams, joints, rivets, bolt-heads and nuts within the tank, so that gasoline stored in such wing spaces would not leak out.

That several types of synthetic rubber compounds, known in the trade as "sealants," have been developed for this purpose, none of which is completely satisfactory, for the reason that they either do not continue to adhere completely to the metal during all stresses, or for the reason that the curing of the sealant causes it to become brittle and crack after it has dried. Since no sealant has been discovered to date that will both completely adhere to the metal and remain resilient and stay in place as long as the aircraft is used, it is necessary from time to time to remove the sealant from the fuel tanks and to replace the sealant, in order to prevent leaks developing therein.

That the need for removing the sealant from the integral fuel tanks of aircraft first became apparent about 1940. That in taking off, flying and especially when landing an aircraft, there is considerable flexing of the wings, caused by stresses. It has been found that for these reasons and because of cracking of the sealant or its not staying in place, the sealant develops dangerous leaks.

That during World War II the military services were the [113] principal users of the wing spaces as integral fuel tanks. However, after said war, the

commercial aircraft companies also began using the wing spaces as integral fuel tanks, and about 1946 the commercial need for "desealing", or removing the sealant, developed.

That the first method used for desealing was purely a manual method, to wit, a person had to crawl into the tank and endeavor to work in cramped, darkened quarters, e.g., a space of only ten inches high in which to do the work in some aircraft wing tanks, and the workman had to have an artificial light. This method was slow, arduous, expensive and unsatisfactory. That all the old sealant had to be removed, for in case some of the old sealant were left therein, it was disposed to crack or to pull away from the metal and cause leaks in the new sealant that would be applied over the old sealant.

That the next method tried was known as the "fill-soak-and-drain method." This method comprised filling the integral fuel tank with a liquid solvent that attacked the sealant. The solvent was allowed to remain in the tank and soak the sealant for a number of days. Then, the solvent and any loosened sealant were drained out of the tank. Thereafter, a person had to crawl into the tank in a protective suit, which has been termed in the industry a "Man from Mars" suit, which fully covered and protected the workman. An air hose, of course, was necessary since the solvent was volatile and highly toxic. The workman would receive burns if he came in direct contact with the solvent or stripper.

That objections to the fill-soak-and-drain method are that it is expensive, dangerous and very time-consuming. That, by way of analysis, it took 3,000 gallons of said solvent to fill the integral fuel tank of a Douglas DC-4 model aircraft, the cost of which solvent amounted to \$9,000.00. That the time consumed for carrying out this fill-soak-and-drain method in said model aircraft ran about two weeks, and took approximately 1,200 man [114] hours. The large amount of expensive solvent that was required and the length of time it was necessary to keep the airplane out of service during the operation, made the cost of such descaling operation so expensive that the commercial aircraft companies could not afford to clean the wing tanks of their aircraft, except on a few jobs of exceptional necessity.

That up until the time of the method of the patent in suit, no one had discovered any effective solution to the problem. Up to that time, about the only attempts in solving the problem had taken the form of developing new solvents for use in carrying out the old fill-soak-and-drain method.

That when the method of the patent in suit was first disclosed to the technical men in the aircraft industry, they expressed to me the view that, due to the peculiar problems attending the removal of sealant compositions from integral aircraft tanks, the method would not work. For instance, they called attention to the fact that the way in which the solvent compounds were located in the joints, they would not be sufficiently exposed to a sprayed solvent as to react sufficiently with it and be re-

moved by such spray. They also called attention to the danger that the breaking up of the solvents into a continuous spray in the tank would increase the toxic and poisonous fumes which would render the procedure too dangerous to workmen.

However, after observing commercial demonstration of the patented method by the defendant, they expressed the view to me that not only did the patented method remove all the solvent compounds from the tank, but that it did so in a more complete and effective manner. For instance, instead of the solvent vapors created by the spray producing a hazard, as they had feared, it was found that, by sealing the wing tank during the operation, those vapors performed the entirely unexpected result of themselves attacking the sealant compounds which were located in [115] portions of the joints which could not be effectively or directly reached by liquid solvents. That result was not foreseen!

Another unexpected advantage of the patented method was that there was a heat generated by impingement of the spray on the sealant which caused volatilization of the solvent at the very point where needed. This appeared very effective in the solvent attacking the sealant.

Furthermore, it was found that, by use of the patented method, it was possible to clean portions which had theretofore been impossible to clean by any previously known method. That is, for instance, it enabled the cleaning of "stringers". Stringers are narrow, hollow, longitudinal strengthening elements which extend from the fuselage throughout



the length of the wings, and in order to seal the integral wing tanks it is necessary to put sealant compound within those long, narrow hollow stringers. For instance, the Wyandotte Chemical Company made a study and report, at a cost of \$150,000.00, for the United States Air Force in connection with this problem of cleaning the stringers, and after said study concluded that it would not be possible to clean them without rebuilding both wings of the aircraft. However, in my presence it was demonstrated that the patented method would successfully and easily clean such stringers and as a consequence the United States Air Force has now issued technical order No. 1C-54-88 requiring that the stringers be cleaned when desealing an aircraft and, by reason thereof, the standards for desealing jobs done for the United States Government have been materially raised, because of the patented process.

That, as compared with the substantially larger cost of desealing by the fill-soak-and-drain method above described, the patented method when desealing, for instance, a Douglas DC-4 model aircraft takes only 600 gallons of material costing \$1,800.00, and the cleaning operation is completed in approximately five days' [116] time, involving 500 man hours. (That these figures could be compared with the figures given above for desealing the same model aircraft by the fill-soak-and-drain method.) That, in addition to the direct cost of material and labor, there is the indirect cost caused by the loss of flying time of the plane while it is being de-



sealed. This has been calculated to amount to about \$4,000.00 per day per plane. Thus, with a reduction in the time on the ground, there is a great saving indirectly by the use of the patented method.

That an additional advantage of the patented method over the fill-soak-and-drain method is that the progress of the sealant-demoving job can be observed by merely shutting down the pump, removing the hatch and looking inside the tank; whereas to observe progress of the fill-soak-and-drain method, it would have been necessary to have removed all the fluid from the tank before a person could look inside.

That a still further advantage of the patented method is that a rinse may be sprayed in the tank, while it is still sealed shut, in order to wash toxic solvent materials from the atmosphere within the tank, and to prevent their escape into the atmosphere around the aircraft where the workmen are. This was not possible with the fill-soak-and-drain method, since the hatch had to be opened, permitting escape of the toxic and very volatile fumes into the atmosphere around the plane, before any rinse could be sprayed inside.

That by continuous spraying of the sealant in an integral aircraft wing tank, strips or pieces of the sealant are removed. These strips or pieces are lightweight, slimy, gooey, jelly-like or sponge-like masses that are substantially the same specific gravity as the solvent, so that such pieces of swollen sealant are substantially held in suspension by the flowing solvent; that is, the spongy, jelly-like, light-

weight sealant neither descends [117] nor rises in the flowing solvent but is carried along by the solvent. Such sealant is, therefore, very difficult to separate from the solvent. That unless this jelly-like material is removed from the solvent, two bad effects will result: (1) the pump will become clogged; (2) fine particles of the jelly-like mass which would be chopped up by the pump before it is clogged, would clog the spray openings inside the fuel tank. When in full operation, this clogging would take place in minutes, say in the order of two, three or four minutes, and thus the system would become inoperative upon removal of the first pieces of sealant.

That the defendant's apparatus, employing the patented method, utilizes a 300-gallon tank or reservoir for the solvent, and the solvent circulates at the rate of 150 gallons per minute, which rapid flow prevents any settling of the spongy, jelly-like pieces of swollen sealant. That such a rapid rate of flow would render an overflow outlet or weir valueless for separating jelly-like, swollen sealant from the solvent, since the swollen sealant material would largely flow over the overflow or weir along with the rapidly moving solvent and clog up the pump and sprays, as stated.

That the "fine mesh strainer" of Oakite (Exhibit H, p. 4), which is "cylindrical" and "has an area of not less than three square feet of ten mesh wire", and is in every suction line that leads "from each tank to the intake opening of the pump", is to remove metal scale that is displaced from the interior

of the tank car, and would not screen out "sealant from the solvent" as specifically covered in most of the claims of the patent in suit. A three square foot—ten mesh fine strainer would be clogged by the swollen, spongy sealant in about two minutes if used to try to remove such sealant in the patented process.

The synthetic rubber compound that is used for a sealant [118] is water-insoluble and water-repellent. On the contrary, the solvent used to spray on the sealant is of such nature that it is absorbed by the sealant, which becomes swollen with the solvent. This swelling causes the sealant to release itself from the wall of the aircraft tank. The solvent is a highly volatile material, so that if the tank were opened at this point and the solvent allowed to evaporate, the sealant would again form hardened, water-insoluble deposits within the fuel tank.

Applying water to the sealant at this point, while the sealant is thus swollen with solvent, would cause the sealant to re-set. As one means of avoiding these difficulties of the solvent evaporating or re-setting, the patented method, *inter alia*, contemplates the use of a spray of a material that is both miscible with the solvent and is water-rinsable. This spray may be separate from the solvent spray or they may be simultaneously sprayed according to the patent in suit. Soap or a soapy solution is not solvent-miscible and would not prevent the solvent from evaporating, and would not prevent the sealant from returning either to a hardened material or to a water-insoluble material. In fact, soap or a

soapy solution would wash away the solvent and definitely cause the sealant to re-set as a hardened rubber compound, so soap or a soapy solution would be inoperative and produce just the opposite results from those desired.

That a "cleansing liquid such as water, salt water, caustic solution or the like" (referred to in Butterworth patent No. 2,018, 757, p. 1, col. 1, ll. 19-20) would not be solvent-miscible, and instead of removing sealant that is saturated with solvent, such "cleansing liquid" would wash out the solvent and tend to re-set the sealant against the wall of the fuel tank in hardened masses.

Having the solvent 60° F. to 100° F. (see claim 3 of the patent in suit) is not an arbitrary range. Heating the solvent [119] to "150° F. to 180° F. or higher", as done in Butterworth patent No. 2,018, 757 (p. 1, col. 1, ll. 37-38), would not be satisfactory. It would tend to volatilize the solvent too quickly—before it could impinge strongly, in a full liquid state, upon the sealant. It is best to create the heat by the impingement, at the time of impact—not ahead of time, which would reduce the force of the liquid spray by tending to vaporize it.

That, as a consequence of the use of the patented method, not only has the United States Government, and others, been saved a great deal of money in desealing aircraft wing tanks, but at the same time the convenience, speed, safety and standards of desealing have been substantially advanced.

That it is believed clear from the foregoing why the method covered by the patent in suit is used

almost universally in the industry today — to the almost entire exclusion of the old fill-soak-and-drain method.

That the plaintiff is a relative newcomer in the desealing industry, compared to the defendant or Turco Products, Inc., and had not theretofore engaged in the desealing business, did not have any part in initiating the recirculating spray method, and did not do any of the pioneering work to make it practical.

/s/ KEITH R. WHITCOMB.

Subscribed and sworn to before me this 28th day of March, 1957.

[Seal] W. W. DUFRESNE,  
Notary Public in and for the County of Los Angeles, State of California. My Commission expires May 6, 1960. [120]

[Title of District Court and Cause.]

AFFIDAVIT OF WILLIAM DOUGLAS  
SELLERS

State of California,  
County of Los Angeles—ss.

William Douglas Sellers, of the aforesaid County and State, being first duly sworn, on oath deposes and says that he is an attorney at law admitted to practice before the Supreme Court of the State of California, and has specialized in patent law for thirty years. That in the year 1925 he graduated from the California Institute of Technology and holds other degrees. As a part of his work as a



patent lawyer, he has engaged in the prosecution of thousands of patent applications, both as an Examiner in the Patent Office and as an attorney before the bar of the Patent Office. That he has also handled the litigation of patent cases in the Ninth Circuit, the Seventh Circuit, in the District of [121] Columbia, and before the United States Supreme Court.

That affiant has examined United States Letters Patent No. 2,653,116 issued to Cee-Bee Chemical Co., Inc., on a Method of Removing Sealant from Fuel Tanks, on September 22, 1953, invented by Keith R. Whitcomb and Eugene E. Finch and which is hereafter referred to as the patent in suit.

That the method covered by said patent in suit is a closed-circuit method, which includes, inter alia, (a) spraying a volatile, toxic solvent within an integral fuel tank in an aircraft to remove and loosen sealant therein, (b) gravitationally draining the mixture of solvent and removed sealant material from the tank, (c) screening the sealant from the solvent, (d) returning the solvent to the said fuel tank under pressure for respraying against remaining sealant in the interior of the fuel tank, and (e) applying water under substantially higher pressure to remove further sealant that is loosened but not removed by the solvent spray, and draining the water, loosened sealant and rinsed solvent from the tank.

That the following eight prior patents were cited by the Patent Office Examiner during the prosecution through the Patent Office of the patent in suit

(which prior patents are also listed at the end of the patent in suit):

Butterworth	Re. 19,374
Foster	1,141,243
Gray	1,628,141
Haupt	1,892,950
McFadden	2,092,321
Paulson et al.	2,123,434
Jaffa	2,442,272
Brady	2,458,333

That the plaintiff is relying upon certain patents not cited by the Examiner in the Patent Office, but which are no more [122] relevant or persuasive of non-invention in the Whitcomb et al. patent 2,653,116, than the above patents cited by the Examiner. This additional art comprises:

Butterworth	2,018,757
Butterworth	2,045,752
Land	1,666,015
Jensen	1,730,658
Olsson	2,065,462
Robinson	1,701,824
Court	2,245,554

Of these patents the plaintiff apparently feels Butterworth 2,018,757 (Fig. 3) and Land 1,666,015 to be of greatest interest, and I will discuss these first.

Annexed here to is "Exhibit 9" which consists of a copy of the drawing of the patent in suit, of claim 6 thereof in which numbers "(1)" to "(8)" have been inserted to define the parts thereof, and

of an enlarged copy of Fig. 3 of the Butterworth patent No. 2,018,757. That said parts of said claim 6 have lines drawn therefrom to respective parts of the patented structure which carry out the respective steps of claim 6, except clause (7) which refers to column 4, lines 59-64 of the patent in suit. That said "Exhibit 9" indicates, by the repeated use of the word "None," the steps and parts of claim 6 of the patent in suit which are not found in said Butterworth patent and which steps, being directed to the removal of a sealant, are not suggested or anticipated in said Butterworth patent.

Also annexed hereto is "Exhibit 10", which is a copy of a claim 3 of the patent in suit, except that numbers "(1)" to "(8)" have been added, and an enlarged copy of Fig. 3 of said Butterworth patent No. 2,018,757. Also lines have been drawn from the clauses in said claim 3, and under a heading "Anticipated?" are listed "No," "No time nor spray material mentioned," "No pressure [123] mentioned," or "?," which legends indicate which parts of said claim are not found in said Butterworth patent. The question mark, "?," indicates that the temperature limitations of 60° F. to 120° F. cannot be found in said Butterworth patent.

It should be noticed that claim 3, like all of the claims of the patent in suit, is a method claim, and not an apparatus claim.

Said Butterworth patent does not remove sealant, as explained; does not remove it from an integral aircraft wing fuel tank, which is irregularly shaped, but from a smooth, cylindrical interior of a

tank car; does not use a volatile solvent, or use it for two to eight hours. In Butterworth, the cleaning liquid is heated "150° to 180° F. or higher" and would probably quickly mix with and remove the oil in a few minutes, since it states that the cleaning is "efficient," and that, "The hot water \* \* \* washes the oil and other formed material from the walls" (emphasis added, since a "washing" operation is generally considered a process that is not prolonged). Dealing with an aircraft sealant, or anything comparable, was not suggested by Butterworth. The pressure of thirty to ninety pounds per square inch is also not mentioned in that prior patent; merely enough pressure needs to be used for the hot sprays 30 of Butterworth to reach the walls in the tank and wash down the oil, etc. The pressure of the patent in suit is not taught by this prior patent.

A feature of claim 3 of the patent in suit, that is in no way suggested by the Butterworth patent, is the additional step of a second and different spray, to wit, "a substantially less volatile \* \* \* spray to the solvent." One and only one spray is suggested by Butterworth for any single washing operation. The patent in suit, however, teaches not only that this second and different spray is to remove the first spray, but that this second spray is (1) water-rinsable and (2) at the same time solvent miscible. No second and different spray to wash out an [124] initial spray material is even remotely hinted at in Butterworth.

Additionally, Butterworth does not then show

water being applied at a very much higher pressure, to wit, three hundred pounds per square inch, which is the last element of claim 3 of the patent in suit.

In short, Butterworth falls far short of showing the different elements of claim 3 of the patent in suit, as stated.

That in my opinion the Butterworth patent No. 2,018,757 does not show or describe the process of the said patent in suit. Butterworth is directed to removing a residual oil film and not to the problem of separating from a tank a sealant that is essentially an integral part of the tank in normal operation, and without which sealant the tank is inoperative for fuel storage.

Butterworth in the use of his said patented structures endeavors to clean "oil encrusted tanks." In doing so, he has to separate oil from water. He does this by letting the "oil and water stratify." In his tank car cleaner (Figs. 2 and 3), he has two separating means, to wit, oil is allowed to drain off "through a line 39 to a ditch 40," which acts as a weir overflow, and he has a weir 38 in basin 35 behind which "scale or other solid material" will settle. The Butterworth patent does not teach that this would be operative for separating jelly-like pieces of sealant from a liquid having substantially the same specific gravity, in a comparatively rapid flow.

I have also carefully examined the Butterworth patent Re. 19,374, cited by the Examiner in the prosecution of the patent in suit through the Patent Office, and have found that it is generally the same



as Butterworth patent 2,018,757 now relied upon by plaintiff. The said reissue patent Re. 19,374 has a settling chamber 7 in which the "sediment will settle out" and the "same cleaning liquid [is] used over again." This patent has a recirculating pump 9 fed by an inlet pipe 10 whose inlet is above [125] the settled sediment in chamber 7, whereby it acts as a weir the same as the overflow weirs of the first-mentioned Butterworth patent.

The Land patent No. 1,666,015, also relied on by the plaintiff, has been carefully considered by affiant. This patent obviously contemplates only the cleaning of tank cars which contained something miscible with cleaning fluid (such as gasoline, oil, milk, etc.) or soluble in the cleaning liquid (such as molasses). No separating means of any kind is provided. In other words, Land is not intended nor adaptable to cleaning out tank cars in which there is a substance that will clog the pump (such as the present sealant). In this respect, the Land patent is even more remote than Butterworth Re. 19,374 (cited by the Examiner), or Butterworth 2,018,757 (which at least has overflow weirs, even though they would not be operative for the present purposes).

The Patent to Jensen 1,730,658 teaches no filter as the plaintiff contends. The pipe and its connection are described on page 1 of the specification at lines 56 to 59, inclusive, and no mention is made of a filter. As a matter of fact, the draftsman simply was not careful and he forgot to leave the top of the pipe 5 open. At the place where the plaintiff

says there is a screen, the draftsman indicates a solid wall. The accepted cross hatching indication for a screen is a wavy line with dots in the valleys upon both sides. No such indication is shown in the Jensen patent.

None of the prior patents cited by the plaintiff teaches (1) removing sealant from an integral fuel tank of an aircraft; nor (2) removing sealant from multiple cells of an aircraft fuel tank "divided by at least one bulkhead"; nor (3) impinging volatile solvent "upon opposite sides of the bulkhead"; nor (4) draining solvent and its carried sealant by gravitation "from one cell to another"; nor (5) screening "pieces of sealant" from the solvent. [126] (The foregoing, *inter alia*, are all in claim 4 of the patent in suit.)

The remaining patents called to attention by the plaintiff are of less relevancy than those referred to above.

Robinson 1,701,824 relates to the flushing out of automobile radiators. The radiator is turned upside down and flushed out. Collected sediment is removed. Turning an airplane upside down is rather impractical, and in any event, aircraft sealant could not be removed without any spray, merely by a reverse flow. This is a far cry from a method of rebuilding the sealed fuel tanks of aircraft by removing an integral lining, a task previously so difficult that men actually climbed inside and did the work by hand.

Butterworth 2,045,752 is directed to an entirely different problem, to-wit, the washing and in effect

sweeping of a residual deposit along the bottom only of a tank car, toward a central outlet, by the use of jets of steam. This patent employs a settling tank. A settling tank is only of use if a large volume of inexpensive solvent is to be used. The use by Whitecomb et al. of a screen makes possible the use of a relatively small volume of fluid moving at a relatively great velocity and so reduces cost. Again nothing is taught in the field of aircraft fuel tank reconstruction.

Olsson 2,065,462 is directed to removing an oily viscous film, and does not circulate the fluid after spraying it out once. It is a batch process, requiring the material that collects at the bottom of the boat to be pumped out "by the ship pumps" (page 2, column 1, lines 32-37). This patent is even less relevant than 1,701,724. It teaches nothing to the field of fuel tank rebuilding.

Court 2,245,554, entitled "Hydraulic Disruption of Solids," is directed to the removal of carbonized deposits in a coking [127] chamber, by what is in effect drilling by powerful jets of water only (up to 1200 pounds per square inch) and making successively larger holes in a bed of coke or the like. An expert in the field of aircraft fuel tanks could not be expected to know about coking chambers. If the methods used were identical (which they are not), there still would be invention in going from one of those remote fields to the other. This Court patent does not use a volatile solvent (only water), does not use a less volatile solvent-miscible spray to rinse out the first solvent, and

then remove both of such materials by a much higher rinse. In other words, this patent does not teach such steps of the method of the patent in suit.

None of the prior patents relied on by the plaintiff in the present motion, nor any of plaintiff's Exhibits G, H, K, L or M, teaches the use of a "less volatile" emulsifier that is "solvent-miscible," between the use of a volatile solvent and just water, as specifically called for in claims 2 and 3 of the patent in suit. As stated in claim 1, this second spray is emulsifying "to the sealant." None of such prior art, relied on by the plaintiff, has or suggests such a three-step method.

None of the prior patents relied on by the plaintiff describes a method that includes spraying with a toxic material that is injuries to personnel, and then removing the injurious fumes by a water spray, before they can escape into the air, by means of a closed, recirculating system.

Also appearing to be new in the art of removing sealants over the art relied upon by the plaintiff is the subject matter of claims 6 and 7 of the patent in suit, which claims not only cover the process discussed hereinbefore, but also cover (1) loosening (but not removing) portions of the sealant with a spray of solvent under a pressure of approximately thirty to ninety pounds per square inch, which saturates and softens the sealant and removes [128] some of the sealant, and (2) then applying water under substantially higher pressure (e.g., pressure of at least approximately three hundred pounds per square inch) "to remove further



portions of the sealant that are loosened but not removed by the solvent spray.”

The alleged prior art patents, relied on by the plaintiff, in fact come from non-analogous arts spaced from the field in which the invention of the patent in suit lies, and it is a question of fact of great doubt that the relationship is sufficiently close that those arts may be called analogous. This is a question of fact which can be decided only upon consideration of expert testimony.

The invention of the patent in suit relates to the field of rebuilding sealed fuel tanks in aircraft. More specifically it relates to the removal of a sealant intentionally secured on the interior of the tanks and having a thickness up to one and one-half inches. Here is no question of washing oil, milk or scum undesirably adhering to a tank surface. Here is the matter of removing not “dirt” but a permanent part of the tank, and more specifically by the use of a relatively small quantity of expensive solvent in the absence of a settling tank or tanks.

The field of the removal of the normally permanent sealant from the interior of an aircraft-wing fuel tank relates to the field of washing adherent milk or oil from the tank wall in about the same way that removing the permanent stucco exterior of a house relates to washing dirt from the side of a house with a stream of water from a hose. Possibly the stucco could be removed in the same way the dirt is washed off, that is, by a stream of water. The fact is, however, that the two fields



are distinct, one does not suggest the other, and the first to discover that the hose washing technique is suitable for removing otherwise permanent stucco that would not appear to be so removable, should be [129] entitled to protection.

The prior art patents relied upon by the plaintiff relate with few exceptions to the field of washing or cleaning. This is true of the Butterworth patents. It is true of Land 1,666,015. The patent to Court 2,245,554 relates to an entirely non-analogous field in which the problem is the emptying of a coking chamber packed solid with coke. The patent art appears to be principally concerned with washing and cleaning the interior of ships and tank cars. It is not clear why the builders and rebuilders of aircraft should be at all familiar with the cleaning technique used in such fields, particularly where their own problem was not one of cleaning.

The patent in suit is directed to a method. The prior art does not teach that method. It teaches other methods, in other fields. The apparatus may be similar but until the concept that the old apparatus is usable in the new field is taught, it cannot be said that invention was not present in the concept of so using it. At the very least, it is a question of fact requiring expert opinion of the relative relationship of the fields and the problems involved.

A weir is not a screen, according to the dictionary and according to known engineering principles. With a screen, foreign particles are removed by

not passing through the screen, while the remainder of the material passes through the screen. A weir more nearly approaches a dam. With a weir, any separating function results from the settling of the foreign substances from the liquid on the high side. A weir requires a settling tank and a relatively large body of quiescent liquid, in order to permit such settling. A body of solvent that would be large enough to permit settling of a material that has nearly the same specific gravity would be excessively costly.

In connection with the drawings, plaintiff's Exhibits E, K, [130] L and M, which bear notations indicating that they were copyrighted, the fact is that a copyright notice on a paper is not proof of actual publication. A copyright notice is required by copyright law to be placed upon a document which is to be published, but the document may be filed away and never published. The notice is necessary if copyright protection is to be obtained, but since the notice must be placed on the work before publication, the existence of such notice is not of itself proof of publication.

In conclusion, the defendant is not, in affiant's opinion, estopped to contend that prior art patents teaching cleaning operations do not anticipate the Whitcomb et al. patent. Patents in that field were cited by the Examiner and it was at all times contended by the attorney of record that they did not anticipate the claims now in the patent in suit, and the Examiner impliedly admitted the soundness of such argument by allowing the patent in

suit despite such prior patented cleaning apparatus.

Further affiant saith not.

/s/ W. D. SELLERS.

Subscribed and sworn to before me this 11th day of March, 1957.

[Seal] /s/ DOROTHY E. KLIPPERT,  
Notary Public in and for the County of Los Angeles, State of California. My Commission Expires Feb. 13, 1958. [131]

[Exhibit No. 9—Copy of Drawing of the Patent in Suit No. 2,653,116 of Claim 6 is set out at page 310 and Exhibit No. 10—Copy of Drawing of Claim 3 is set out at page 311 of the Book of Exhibits.]

[Title of District Court and Cause.]

### AFFIDAVIT OF JAMES L. JACKSON

State of California,

County of San Bernardino—ss.

James L. Jackson, being first duly sworn, on oath deposes and says:

That he is a Brigadier General in the United States Air Force, presently assigned as Deputy Commander of the San Bernardino Air Material Area, Norton Air Force Base, California. The statements contained in this affidavit are made on affiant's personal knowledge.

Between 1924 and 1927, affiant studied mechanical engineering at the University of Arkansas. In

1928 he became a flying cadet in the United States Army Air Corps. After receiving his wings and commission as a second lieutenant, affiant served as a [134] pilot in the Army Air Corps for two years on squadron duty. In the years 1930 and 1931, affiant studied a course in aircraft maintenance engineering, and graduated from the Air Force Technical School at Chanute Field with the degree of maintenance engineer. Since then, affiant's duties have been almost exclusively devoted to aircraft maintenance for the United States Air Force, or its predecessor, the United States Army Air Force.

During World War II, affiant's commands, among others, included the Air Base at Abadan on the Persian Gulf, where it was affiant's responsibility to assemble aircraft for delivery to Russia. Thereafter affiant was transferred to China, where it was his responsibility to maintain, repair and service all United States Army aircraft in that area; to support their operations and to keep them in condition for the service they were required to render. In 1946, affiant was transferred to Dayton, Ohio, as Chief of the Technical Section, United States Army Air Force. He later became Deputy Chief of all maintenance for the United States Army Air Force throughout the world. This position he occupied until 1949.

In 1949, affiant took a post graduate course at the Industrial College of the Armed Forces, and thereafter was transferred to the San Antonio Air Material Area as Chief of Maintenance Engineer-



ing. At that time, the San Antonio area included the states of Texas, New Mexico, Arizona and Louisiana. The shops under affiant's command employed 12,000 persons, and we were then primarily engaged in repairing and servicing aircraft for the Korean operation. In 1953, affiant was transferred to Africa, and was placed in command of the Southern Air Material Area, (Europe), until the fall of 1955. Since that time he has occupied his present position as Deputy Commander, San Bernardino Air Material Area. This area includes Arizona, the Southern County of Nevada, and half of California. [135]

Affiant first became aware of the problems connected with the leakage of gasoline from aircraft integral fuel tanks in 1940 or 1941, in connection with the P-35 and BT8 (Seversky) Aircraft, while he was stationed at Dayton, Ohio. To affiant's knowledge, these planes were the first that had integral fuel tanks, and it was discovered that in spite of the sealants which were then in use, fuel would leak from the tanks when the planes went through rough air, or upon being jostled due to landing. Again, in 1946, after his return to the United States, one of the first problems with which affiant was confronted was the leaking of fuel from C-54 aircraft (DC-4) which had operated in Alaska. From 1946 forward, the Air Force was greatly concerned with the problem of sealing and de-sealing integral fuel tanks. Many methods were tried, and the vendors and mechanics in the trade worked upon the problems and suggested various methods



whereby the operations could be done more efficiently, more economically and more effectively. Among the problems in this field was that of removing old sealant in order to prepare the surface of the wing for the application of new sealants. To obtain a tight bond between the sealant and the aluminum surface of the wing, it is necessary to have the wing surface "surgically" clean before apply a new sealant. The methods in use between 1946 and 1949 were principally the hand scraping method and the fill, soak and drain method. Both of these operations were inefficient, dangerous to personnel, and extremely costly. In an effort to solve these problems, chemical suppliers suggested the use of different chemicals, and variations on the methods of de-sealing or stripping the sealants that were then in use.

None of the methods suggested proved to be satisfactory, and they were all extraordinarily expensive. We found a particularly critical problem in connection with the B-36 aircraft. The wings of that aircraft contained a "sandwich" of a gummy [136] material, which was designed to immediately seal up bullet holes and prevent the leakage of fuel from the wing tanks. The tanks of these aircraft were so large that men could stand and walk in them, and the pressure of the chemicals within the tanks through the use of the fill, soak and drain method caused the chemical to leak into the "sandwich" and destroy this gummy material. Convair, the manufacturer of that aircraft, was most anxious concerning this problem, and no solution was found

until the Cee-Bee Chemical Company demonstrated the operation of its recirculating spray method during the latter part of 1951.

This was the first time that either I, or anyone who worked under me at our shops, had heard of such a system in connection with the stripping of sealant from integral fuel tanks. When this method was first brought to my attention, I was skeptical of it, and did not believe that it would be workable. It did not seem to me that the mere spraying of the chemical through small apertures would sufficiently concentrate upon the sealant to perform the job effectively, and, in addition thereto, I considered that it might be more dangerous than previous methods then in use. However, my skepticism was dissipated upon observing the operation of the recirculating spray system and calculating its beneficial results.

This system saved hundreds of man hours, and did not destroy the B-36 "sandwich." Prior to the use of the Cee-Bee method of de-sealing, the B-36 has constant leakage problems, but after the de-sealing with the Cee-Bee method and the application of new sealant, the aircraft worked satisfactorily.

I have examined a soft copy of the patent in suit, namely, Whitcomb 2,653,116, and find that the recirculating system which I observed demonstrated by the Cee-Bee Chemical Company was the same as that disclosed in the patent in suit. To my knowledge, no one in the Air Force, or in the industries who served the Air [137] Force, con-

ceived of using this recirculating method to strip sealant from the inside of integral fuel tanks prior to the Cee-Bee Chemical Company, although a pressing need for an improved method of de-sealing integral fuel tanks had existed for several years. I attribute the increased efficiency, lower cost, and greater effectiveness of the recirculating spray method to the method itself, and not the chemicals which are presently used. We have found that it is far less expensive for the Government to pay the fees of the Cee-Bee Chemical Company for performing the stripping operation than it is to employ our own men and use one of the other methods of performing this task.

/s/ JAMES L. JACKSON.

Subscribed and sworn to before me this 25th day of March, 1957. [138]

[Seal] /s/ WALTER F. HANSEN.

Notary Public in and for the County of San Bernardino, State of California. My Commission Expires June 24, 1958. [138]

### AFFIDAVIT OF CLAUD D. BLACK

State of California,  
County of Los Angeles—ss.

Claud D. Black, of the aforesaid County and State, being first duly sworn, on oath deposes and says: that he is the President of Cee-Bee Chemical Co., Inc., defendant in the case of Delco Chemicals, Inc. v. Cee-Bee Chemical Co., Inc., No. 17,387-WM, in the United States District Court, for

the Southern District of California, Central Division; that on the 16th day of July, 1954, the said Cee-Bee Chemical Co., Inc., entered into a License Agreement with Turco Products, Inc.; that the annexed Exhibit 11 is a true copy of said License Agreement which was signed by representatives of said parties; that affiant is the person who signed for the said Cee-Bee Chemical Co., Inc.

Further affiant sayeth not.

/s/ CLAUD D. BLACK.

Subscribed and sworn to before me this 1st day of April, 1957.

[Seal]     /s/ W. W. DUFRESNE,  
Notary Public in and for said County and State.  
My Commission Expires May 6, 1960. [139]

## EXHIBIT No. 11

### LICENSE AGREEMENT

This Agreement made and entered into this 16th day of July, 1954, by and between Cee-Bee Chemical Co., Inc., a California corporation, having its principal place of business in the County of Los Angeles, State of California, hereinafter called Licensor, and Turco Products, Inc., a California corporation, having its principal place of business in the County of Los Angeles, State of California, hereinafter called Licensee.

Witnesseth, That

Whereas, Licensor warrants that it owns and

## Exhibit No. 11—(Continued)

controls United States letters patent No. 2,653,116, and has the right to grant this license, and

Whereas, Licensee is desirous of acquiring and Licensor is desirous of granting the license rights hereinafter set forth under said patent.

Now, Therefore, in consideration of the premises and the mutual covenants of the parties herein contained, the parties have agreed and do hereby agree as follows:

1. Licensor grants unto Licensee a license in the United States and throughout the world, to use the methods of said patent and to make and vend apparatus and solvents for use in accordance with said methods. [140]

2. Licensee agrees to pay to Licensor as royalty the total sum of \$2,000 per year commencing on even date herewith, and receipt of the first year's said royalty is hereby acknowledged by Licensor. Future said royalties shall be due and payable on or before the first day of August of each year.

3. It is agreed that this license is exclusive excepting only that Licensor reserves a like right in the United States throughout the world to use the methods of said patent and to make and vend apparatus and solvents for use in accordance with said methods.

4. Licensor hereby waives and releases and acknowledges full satisfaction and settlement of any and all claims for past infringement upon said pat-



## Exhibit No. 11—(Continued)

ent which Licensor may have against Licensee for infringement of said patent or against any customer of Licensee for past use of apparatus vended by Licensee for using solvents in the cleaning of airplane fuel tanks.

5. Licensee hereby waives, releases and acknowledges full satisfaction and settlement of any and all claims which it may have against Licensor for past alleged acts of unfair competition.

6. If Licensee shall default in payment of royalty hereunder when due Licensor may cancel and terminate this license by giving to Licensee written notice thereof provided, however, that if Licensee shall cure said default within 30 days after receipt of said written notice, this license shall remain in full force and effect.

7. At any time after ten (10) years from date hereof, Licensee may cancel and terminate this license agreement by giving to Licensor sixty (60) days written notice of its election so to do. However, if said patent shall at any time be declared invalid by a final judgment of a Court of competent jurisdiction this license agreement shall, at the option of Licensee, become ipso facto terminated.

8. If any third party or parties shall infringe said letters patent and Licensor shall fail to institute suit against said infringer or infringers for said infringement within sixty (60) days after Licensee shall notify Licensor thereof in writing, Licensee shall then have the right to sue said in-

## Exhibit No. 11—(Continued)

fringer or infringers and join Licensor as party plaintiff in such suit, provided Licensee shall pay all costs and attorneys fees incurred or awarded by the Court in said suit and shall receive any recoveries therein.

9. Unless sooner terminated as hereinabove specifically set forth, this agreement and license shall endure and bind and benefit the parties hereto, their successors and assigns until said letters patent shall expire.

10. It is mutually agreed that the parties shall, through their respective attorneys, concurrently with the execution hereof, sign and promptly file a stipulation for a Court order dismissing, without prejudice and without costs, the complaint and counterclaim in that certain action now pending in the United States District Court for the Southern District of California, Central Division, No. 16,-103-C, entitled Turco Products, Inc., Plaintiff-Counterdefendant vs. Cee-Bee Chemical Co., Inc., Defendant-Counterclaimant.

In Witness Whereof the parties have executed this license agreement on the day and year first hereinabove written.

CEE-BEE CHEMICAL CO., INC.,  
By C. D. BLACK,  
Licensor.

TURCO PRODUCTS, INC.,  
By DALE M. LeVASSEUR,  
Licensee.

Duly Verified.

## AFFIDAVIT OF VESTA M. NELSON

State of California,

County of Los Angeles—ss.

Vesta M. Nelson, of the aforesaid County and State, being first duly sworn, on oath deposes and says: that she is employed by C. G. Stratton, Patent Lawyer, of Los Angeles, California; that on the morning of the 1st day of March, 1957, she looked in the Central telephone directory of the city of Los Angeles for the telephone number of Oakite Products, Inc., and found the number to be MAdison 5-1544; that she then called that number by dialing it in the usual and customary manner and the operator at the other end answered, stating it was Oakite Products; that affiant then asked to speak to Mr. George H. Boeck and the operator informed affiant that Mr. Boeck was not in the office but that he could be reached by calling the number "TEexas 0-2039", whereupon affiant called TEexas 0-2039 in the usual and customary manner by dialing it on the telephone and an individual answered said number and, upon inquiry, identified himself as George H. Boeck, the person of that name who made an affidavit designated "Exhibit H" and attached to Plaintiff's Motion for Summary Judgment in the action of Delco Chemicals, Inc. v. Cee-Bee Chemical Co., Inc., No. 17-387-WM, in the United States District Court, for the Southern District of California, Central Division; that the said C. G. Stratton then talked to the said George H. Boeck, hereinafter referred to as Mr.

Boeck, and, at the outset, explained to Mr. Boeck that affiant was sitting in on said conversation, which affiant did.

That in the course of said conversation, Mr. Boeck stated that his duties as an employee of the said Oakite Products, Inc. caused him to be in the field; that he did not work in the offices of said company. That as a field man, he had no personal knowledge of what the said Oakite Products, Inc. sent out to its [141] different field men, except what he personally received from the company by mail. That he was not present when any copies of Exhibits G, H, K, L or M, attached to said Motion for Summary Judgment, were mailed out or distributed by said Oakite Products, Inc.; that he only knows what he himself received by mail.

That he was not present when the drawings, Exhibits K, L and M, or the typewritten pages, Exhibits G and H, were produced, and he does not know of his own knowledge how many of same were produced. That the said Mr. Boeck was not present when any of the other representatives of said company purportedly gave out copies thereof, and does not have any personal knowledge as to what was given out by said other representatives, or to whom.

That Exhibit M bears the statement, "Redrawn 1/9/48," and Mr. Boeck stated that he did not have the slightest idea what part of 1948 they were produced, and did not know what part of that year he gave out the first copy of same.

That down to 1956, the said Mr. Boeck had only given to customers or prospective customers about

ten to fifteen of the Exhibits G, H, K, L, and with few exceptions, they had been given to customers or prospective customers in Los Angeles County, California.

That the said Mr. Boeck stated he had only given out a half dozen copies of Exhibit M down to 1953, and that Exhibits G and H were never given out by him except when they were attached to the drawings K, L or M, so no more copies of G and H were given out than said drawings. That he had only given out Exhibits G, H, K, L or M to customers or prospective customers of Oakite Products, Inc., with whom he had gone over the whole thing personally, because they were too highly involved for general distribution. That said exhibits were kept by him for his own customers and his own prospective customers.

That Exhibits G, H, K, L and M were only given by Mr. [142] Boeck to his customers and prospective customers to guide them in maintaining the efficient use of equipment which they had purchased from or were believed to be in the market to purchase from Oakite Products, Inc.

That both Mr. Boeck and Oakite Products, Inc. restrict the use of copies of said exhibits by the parties hereto, to use thereof in this action, and that they were not produced in this action for the general use thereof by the plaintiff or defendant, who are competitors of the said Oakite Products, Inc. That the latter company spent years developing the subject matter of these drawings, Exhibits K, L and M, and these typewritten pages, Exhibits



G and H, and that they have not been disclosed to the parties hereto for their use or distribution by them in the industry, for Oakite Products, Inc. does not want to encourage competition.

/s/ VESTA M. NELSON.

Subscribed and sworn to before me this 1st day of April, 1957.

[Seal] /s/ ESTHER DONNELLAN,  
Notary Public in and for said County and State.  
My Commission Expires July 8, 1958.

Copyright Office of the United States of America,  
The Library of Congress, Washington.

This Is to Certify that a careful search in the General Indexes and Copyright Office Card Catalog covering the period from 1938 through January 2, 1957 under the names Oakite Products, Inc., Gene Get and the titles Oakite Interior Tank Cleaning Unit Model 324, Two Tank Installation Drawing D-463-S1, Oakite Interior Tank Cleaning Unit Model 324, Four Tank Installation Drawing No. D 463-S2, Oakite Inside Drum Cleaning Equipment Drawing No. C-222, 1947; failed to disclose any separate registrations for works identified under these names and these specific titles.

In Witness Whereof, the seal of this Office has been affixed hereto this thirteenth day of March 1957.

[Seal] ARTHUR FISHER,

Register of Copyrights,

/s/ By WILLIAM P. SIEGFRIED,  
Assistant Register of Copy-  
rights. [144]

In the United States District Court, Southern  
District of California, Central Division

No. 15,820-WM

CLARENCE P. TAYLOR, Plaintiff,

vs.

KEUFFEL and ESSER COMPANY OF NEW  
YORK, a corporation, et al., Defendants.

REPORTER'S TRANSCRIPT OF  
PROCEEDINGS

Los Angeles, California  
Monday, September 13, 1954

Honorable William C. Mathes, Judge Presiding.

Appearances: For the Plaintiff: C. G. Stratton,  
Esq. and Louis M. Welsh, Esq., 210 West 7th  
Street, Los Angeles 14, California. For the Defend-  
ants: Harris, Kiech, Foster & Harris, by Warren  
L. Kern, Esq., 417 South Hill Street, Los Angeles  
13, California. [146]

Monday, September 13, 1954; 11:05 a.m.

(Other court matters.)

Mr. Welsh: Your Honor, may I have permission  
to address the court? I would like to inform the  
court that Mr. Kern is here. That is in the case that  
is No. 81½ on your civil calendar, sir.

The Court: I take it that means Case No. 15,820,  
Taylor against Keuffel and others.

Mr. Kern: Yes, your Honor.

The Court: Is there anything to be said in oppo-

sition to this motion that isn't said in the memorandum, Mr. Kern?

Mr. Kern: Well, actually, of course, this started with a motion to strike a jury demand, and they made a motion to amend——

The Court: They both mean the same, you know.

Mr. Kern: Yes. I think the sole question for the court to determine is whether it should exercise its discretion to order a jury trial in this type of case. The court has wide discretion in the matter.

The Court: I am favorably disposed to grant a jury trial to anyone who wants a trial by jury, even in a patent case. Some day the courts will have to make up their minds whether invention is a question of fact or a question of law.

You can probably submit that issue to the court in advance of the trial, if you like, upon motion for summary [147] judgment, if you feel so advised.

Mr. Kern: I feel that it is a little difficult to make my argument here because, in effect, it may sound as if I am arguing against the jury system, which I am not against at all. But I have been involved in more than one patent jury case, and I can suggest to your Honor that these cases are not of the type that are peculiarly suitable for the jury.

The Court: I will tell you, Mr. Kern, that I agree wholeheartedly with the remarks of Judge Learned Hand with respect to the elusiveness of the non-existent standard for the determination of what is invention.

Now, I daresay that most juries know just about as much about it as most judges.

Mr. Kern: Well, your Honor, I think that most laymen don't even know that a patent can be declared invalid by the courts, and a jury sits there and sees this document with the beautiful seal and the ribbon and most of them aren't aware that there could be any question of that.

The Court: The court of appeals will set it aside, usually set it aside when I declare them invalid, so it's just as well.

Mr. Kern: But, your Honor, there is so much work.

The Court: I never get over the case where the Schick Razor Company, one of the leaders of the industry, offered [148] Jones \$50,000 for his patent. Your office was in that case.

Mr. Kern: That's correct. I was here at the time.

The Court: Here is a leader of the industry who presumably knows all the prior art and offers \$50,000 for this thing and he turns it down. I thought that that was pretty good evidence that he might have something. But the Court of Appeals—I don't know whether they knew better—said it wasn't anything at all and Schick didn't know what he was talking about when he offered this man \$50,000; it wasn't worth a penny, not an invention at all. And then the Supreme Court says, too—well, it takes 13 guesses to determine whether or not a patent is any good—one from the district judge, three from the Court of Appeals and nine from the Supreme Court. And with all due deference, as far as I am concerned, I think 13 people sitting over

there in the box know just about as much about it as I do.

If you want me to decide, bring it up on a motion for summary judgment, give me all the prior art and give me the file, your accused device, and present it all in a motion for summary judgment and I'll take my guess at it in advance of the jury, if you wish to present it that way.

Mr. Kern: Most of the judges here don't feel that they can decide these patent cases on a question of validity on a motion for summary judgment, unless it is very obvious from the prior art to be clear-cut. [149]

It seems to me that your Honor's feeling on the matter is very logical, but I have made several motions for summary judgment in patent cases, and in one or two cases the prior art was very clear and in my opinion I didn't feel there could possibly be any question of a patent being upheld if it ever got to the Court of Appeals.

The Court: I am very fresh on this. I just spent Saturday and Sunday working on a case involving four patents. So I am ready to entertain a motion for summary judgment on the issue of validity in any patent case. After thousands of pages and testimony and hundreds of pages of argument, it would have been just as clear to me if you had just handed me the book with the prior art, the accused device and a copy of the patent and let me study it.

Mr. Kern: I certainly agree with your Honor because we do dispose of a lot of these patent cases a lot more easily that way.



Would your Honor, on such a motion then, consider deposition testimony and read it? Because this invalidity is largely a matter of alleged anticipation by virtue of prior uses, which are set up in depositions.

The Court: Of course, if you get into an issue of fact then it is another problem. If you say there was a prior use and the plaintiff denies it, then you have a genuine issue of fact and a summary judgment would not lie. [150]

I am referring to the question of just anticipation from prior art.

Mr. Kern: If we have prior use testimony by deposition, we are going to have to read that to the jury.

The Court: But if it's disputed the issue will have to be tried. If the prior use is admitted, why, of course, that's another matter.

I will grant the motion for plaintiff to serve and file an amended complaint, and deny the motion to strike the jury demand.

The plaintiff will prepare and settle under Local Rule No. 7 within five days the formal order embodying these rulings.

Mr. Welsh: And I would like, if I may, your Honor, to file a motion to produce documents, which has been served upon counsel.

The Court: You may.

(Other court matters.) [151]

Certificate of Reporter Attached. [152]

[Endorsed]: Filed April 2, 1957.

[Title of District Court and Cause.]

## MEMORANDUM OF DECISION

Appearances: Messrs. Fulwider, Mattingly & Huntley, Robert W. Fulwider, Walter P. Huntley, John M. Lee, 5225 Wilshire Boulevard, Los Angeles 36, California, and John A. Weyl, 6331 Hollywood Boulevard, Hollywood 28, California, Attorneys for Plaintiff. Messrs. Carlos G. Stratton and Louis M. Welsh, 210 West Seventh Street, Los Angeles 14, California, Attorneys for Defendant. [153]

Mathes, District Judge:

Plaintiff brought this action for a declaration of invalidity and non-infringement as to United States Letters Patent No. 2,653,116. [28 U.S.C. §§ 1338(a), 2201.] Defendant answered with a counterclaim for damages for alleged infringement. Plaintiff now moves for a summary judgment declaring the patent invalid. [Fed. R. Civ. P., Rule 56.]

The motion is based upon the pleadings, various affidavits, a copy of the patent in suit, the "file wrapper", and copies of various prior-art patents. Affidavits have been filed in opposition to the motion.

There is no issue of fact, "genuine" or otherwise, as to the contents of the patent in suit, the contents of the file-wrapper record of Patent Office proceedings leading to the issuance thereof, or the contents of the various prior-art patents.

The patent in suit—Letters Patent No. 2,653,116, covering a "Method of Removing Sealant from

Fuel Tanks”—issued September 22, 1953, upon an application filed March 16, 1949 for a patent on both “Method and Apparatus for Removing Sealant from Fuel Tanks.” The file wrapper discloses that the first action of the Patent Office was to declare that “The method and the apparatus are distinct, each from the other \* \* \* [154] and all claims are rejected on the ground of misjoinder.”

Next, claims limited to the method were rejected as unpatentable over the prior art cited. Further method claims were then filed, then amended, then rewritten; personal interviews with the examiner were had; associate counsel appeared; and at length, the Patent Office examiner allowed the eight claims appearing in the letters as issued.

Interestingly enough, the specifications and drawings of patent No. 2,653,116, issued for the “method” alone, are the same as those in the original application for both “method and apparatus.” Indeed, the opening words of the specifications in the letters issued for the method alone are: “This invention relates to a method and apparatus for removing the sealant that lines the interiors of integral fuel tanks, particularly of aircraft.” [Patent 2,653,116, col. 1, ll. 1-5.]

In the language of the defendant’s brief in opposition to the motion for summary judgment, the patented process is a “three-way method, including, first, spraying a volatile solvent against the sealant in an aircraft tank; secondly, spraying the solvent with a ‘water-rinsable, solvent-miscible’ material; and thirdly, applying a water spray of a higher

pressure. The second and third sprays may be applied successively or simultaneously.” [155]

Thus, defendant’s fuel-tank cleaning process can be envisioned as embracing either two or three steps, depending on whether the water rinsing accompanies or follows the “water-rinsable, solvent-miscible” spray.

Plaintiff’s motion for summary declaration of invalidity is made upon the grounds that: “The method claimed by the patent in suit is fully and clearly anticipated by prior art which was not cited or considered by the Commissioner of Patents while the application for the patent was pending \* \* \* The method claimed by the patent in suit is devoid of patentable novelty \* \* \* There does not exist any genuine issue as to material facts necessary to consideration and determination of this motion, since invalidity of the patent in suit is clearly apparent from a comparison of said patent in suit with said prior art which was not considered by the Patent Office but \* \* \* is before the Court in this motion.”

It is often declared generally that validity of a patent is a question of fact. [United States v. Esnault-Pelterie, 299 U.S. 201, 205 (1936); *Faulkner v. Gibbs*, 170 F. 2d 34, 37 (9th Cir. 1948), *aff’d per curiam* 338 U.S. 267 (1949).] But the broad question of validity may encompass a variety of issues, both factual and legal. [35 U.S.C. § 102.]

Whether a method or “process” upon which letters patent have issued is “new and useful”, and

whether first “invented or discovered” by the patentee, are questions of fact. [35 U.S.C. §§ 100, 101; *Oriental Foods v. Chun King Sales*, 244 F. 2d 909, 913-914 (9th Cir. 1957); *Hall v. Wright*, 240 F. 2d 787, 790 (9th Cir. 1957); *Hansen v. Safeway Stores, Inc.*, 238 F. 2d 336, 339 (9th Cir. 1956).]

In the case at bar, the specific question whether “the invention was patented \* \* \* in this country, more than one year prior to the date of the application for patent in the United States \* \* \*” [35 U.S.C. § 102(b)] is one of fact.

The burden of proof necessary to establish invalidity for anticipation, or for other want of invention, rests of course upon the party asserting it. [*Marconi Wireless Tel. Co. v. United States*, 320 U. S. 1, 34 (1943); *Smith v. Hall*, 301 U.S. 216, 222, 232-233 (1937); *Radio Corp. of America v. Radio Eng. Lab.*, 293 U.S. 1, 7-8 (1934); *Eibel Process Co. v. Minnesota & Ontario Paper Co.*, 261 U.S. 45, 60 (1923); *The Barbed Wire Patent*, 143 U.S. 275, 284-285 (1892); *Schmeiser v. Thomasian*, 227 F. 2d 875, 876 (9th Cir. 1955); *Whiteman v. Matthews*, 216 F. 2d 712, 716 (9th Cir. 1954).]

But, as the Court said in *Bates v. Coe*, 98 U.S. 31 (1878), “the patent offered in evidence \* \* \* will be held [157] to be prior, if it is of prior date to the patent in suit, unless the patent in suit is accompanied by the application for the same, or unless the complainant introduces parol proof to show that his invention was actually made prior to the date of the [earlier] patent, or prior to the time the



[earlier] application was filed.” [98 U.S. at p. 33; See *Alexander Milburn Co. v. Davis-Bournonville Co.*, 270 U.S. 390, 399-400 (1926).]

Questions as to validity, such as anticipation or other want of invention, as a rule present “genuine” issues of fact which must be litigated and adjudicated by plenary trial so long as the presumption of validity is available to the defender of the patent. [See: *Radio Corp. of America v. Radio Eng. Lab.*, supra, 293 U.S. at 9; *Hycon Mfg. Co. v. H. Koch & Sons*, 219 F. 2d 353, 356 (9th Cir.), cert. denied, 349 U.S. 953 (1955).] For, although disputable, the presumption of validity cannot be dispelled without an evaluation of the evidence to the contrary. Such an evaluation necessitates the consideration or weighing of all opposing evidence, the drawing of inferences, and the choice of opposing inferences; usually this can be done only after a plenary trial. [See: *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620, 628 (1944); *Hansen v. Safeway Stores, Inc.*, supra, 238 F. 2d at 340; *Hycon Mfg. Co. v. H. Koch & Sons*, supra, 219 F. 2d 353; cf: *Great [158] Atlantic & Pacific Tea Co. v. Supermarket Equipment Corp.*, 340 U.S. 147, 153-154 (1950); *Muench-Kreuzer Candle Co., Inc. v. Wilson*, 246 F. 2d 624 (9th Cir.), cert. denied, 26 U.S. L. Week 3164, 3166 (U.S. Nov. 25, 1957); *Oriental Foods v. Chun King Sales*, supra, 244 F. 2d at 913; *Kwikset Locks, Inc. v. Hillgren*, 210 F. 2d 483, 486 (9th Cir.), cert. denied, 347 U. S. 989, 348 U.S. 855 (1954).]

Since there is no rational basis upon which to

rest it, the presumption of validity cannot extend beyond the scope of the administrative record—the file wrapper of the patent as issued. So the presumption that a patent is valid, as embodying an invention over the prior art, does not subsist as to pertinent prior art not cited or considered by the Patent Office in passing on the application for the patent. [*Jacuzzi Bros., Inc. v. Berkeley Pump Co.*, 191 F. 2d 632, 634 & n.4, 637 (9th Cir. 1951); *Gomez v. Granat Bros.*, 177 F. 2d 266, 268 (9th Cir. 1949), cert. denied, 338 U.S. 937 (1950); *Mettler v. Peabody Engineering Corp.*, 77 F. 2d 56, 58 (9th Cir. 1935); and see *Syracuse v. Paris*, 234 F. 2d 65 (9th Cir. 1956); see, also: *Fritz W. Glitsch & Sons, Inc. v. Wyatt Metal & Boiler Works*, 224 F. 2d 331, 335 (5th Cir. 1955); *Royal Patent Corp. v. Monarch Tool & Mfg. Co.*, 203 F. 2d 299, 300 (6th Cir. 1953); *O’Leary v. [159] Liggett Drug Co.*, 150 F. 2d 656, 664 (6th Cir.), cert. denied, 326 U.S. 773 (1945); *Himmel Bros. Co. v. Serrick Corp.*, 122 F. 2d 740, 745 (7th Cir. 1941); *Nordell v. International Filter Co.*, 119 F. 2d 948, 950 (7th Cir. 1941); *National Elec. Products Corp. v. Grossman*, 70 F. 2d 257, 258 (2d Cir. 1934); *R. Hoe & Co. v. Goss Printing Press Co.*, 30 F. 2d 271, 274 (2d Cir. 1929); *American Soda Fountain Co. v. Sample*, 130 Fed. 145, 149-150 (3rd Cir.), cert. denied, 195 U.S. 634 (1904).]

Such uncited prior art is as if unknown to the Commissioner and, being unknown, could not possibly have influenced his administrative finding of invention. [*Himmel Bros. Co. v. Serrick Corp.*,

supra, 122 F. 2d at 745; Nordell v. International Filter Co., supra, 119 F. 2d at 950.]

One has only to examine the admitted copy of the letters, and of the file wrapper of the patent in suit, to learn there can be no issue of fact, "genuine" or otherwise, that the following pertinent prior-art patents were not cited or considered in connection with the application for the patent at bar:

No. 2,018,757 issued 1935 to Butterworth for "Apparatus for Cleaning Tanks"; [160]

No. 2,045,752 issued 1936 to Butterworth for "Method for Freeing a Container of Asphaltic and Oil Materials";

No. 1,666,015 issued 1928 to Land for "Tank Cleaning Apparatus";

No. 1,730,658 issued 1929 to Jensen for "Can Washing Apparatus";

No. 2,065,462 issued 1936 to Olsson for "Oil Tank Cleaning Apparatus";

No. 1,701,824 issued 1929 to Robinson for "Process and Apparatus for Cleaning Radiators"; and

No. 2,245,554 issued 1941 to Court for Method of "Hydraulic Disruption of Solids."

It will be noted that the "apparatus" patents also describe the claimed inventor's recommended "method" of making use of the cleaning device. In the fuel-tank cleaning art, and analogous arts, the essential steps of the method or process are easily understood from a reading of the claims of the patent in conjunction with the specifications and drawings. [See 35 U.S.C. §§ 111, 112, 113.]

And it is settled that where "it appears that no

substantial dispute of fact is presented, and that the case may be determined by a mere comparison of \* \* \* [processes] and extrinsic evidence is not needed for purposes of explanation, or evaluation of prior art, or to resolve questions of the application of descriptions to subject matter, the questions [161] of invention and infringement may be determined as questions of law." [United States v. Esnault-Pelterie, 303 U.S. 26, 30 (1938); see: Sanitary Refrigerator Co. v. Winters, 280 U.S. 30, 36 (1929); Singer Mfg. Co. v. Cramer, 192 U.S. 265, 275 (1904); Black-Diamond Coal Mining Co. v. Excelsior Coal Co., 156 U.S. 611, 618 (1895); Market St. Cable Ry. v. Rowley, 155 U.S. 621, 625 (1895); Heald v. Rice, 104 U.S. 737, 749 (1881).]

Defendant admits that the above-listed patents were not cited or considered by the Patent Office in passing on the application for the patent in suit. However, defendant denies that the non-cited patents anticipate the claimed invention of the fuel-tank cleaning method described in the patent in suit. As to the non-cited Butterworth patent No. 2,018,757, defendant questions whether any "screen" means is shown "for collecting material dispersed by the solvent and yet permitting drainage there-through of the solvent for re-circulation \* \* \*"[See patent 2,653,116, col. 3, ll. 45-50.]

The specifications in non-cited Butterworth patent No. 2,018,757 describe: "A line 36 connects basin 35 with chamber 24 to introduce the oil contaminated wash water into the chamber. A weir 38 is provided in basin 35 in position to prevent the



passage of scale or other solid material into line 36.” [162] [Butterworth patent 2,018,757, p. 2, col. 2, ll. 25-35.]

Defendant argues that “a weir is in the nature of a dam”; that “Material flows over the top of a weir and not ‘through’ it.” But this is not the teaching of non-cited Butterworth patent No. 2,018,757, as clearly appears from an examination of the drawing of the “weir”, 38 of Fig 2, in the light of the above-quoted specifications.

Moreover, as the examiner observed upon rejecting certain claims during the course of the proceedings in the Patent Office: “A pump drain for the tank is considered the full patentable equivalent of applicant’s gravitational drain, and the separation by settling is considered the full patentable equivalent of \* \* \* screens. Both \* \* \* are considered well within the purview of one skilled in the art, and hence devoid of invention.” [File wrapper pp. 37, 41.]

It is true of course that “a process patent can only be anticipated by a similar process.” [Carnegie Steel Co. v. Cambria Iron Co., 185 U.S. 403, 424-425 (1902).]

It is also true that in a process or method patent, the important thing is a method of procedure, not the particular means by which the method shall be practiced. [Expanded Metal Co. v. Bradford. 214 U.S. 366, 384 (1909); see: Dow Chemical Co. v. Halliburton Oil Well Cementing Co., [163] 324 U.S. 320, 329 (1945); International Steel Wool Corp. v. Williams Co., 137 F. 2d 342, 346 (6th Cir.



1943); *Slayter & Co. v. Stebbins-Anderson Co., Inc.*, 117 F. 2d 848, 851 (4th Cir. 1941).] "The test of the identity of processes is not the apparatus used for carrying them out but whether they involve identical or equivalent steps." [*Celite Corp. v. Dicalite Co.*, 96 F. 2d 242, 248 (9th Cir.), cert. denied, 305 U.S. 633 (1938); see: *Kemart Corp. v. Printing Arts Research Laboratories, Inc.*, 201 F. 2d 624, 629 (9th Cir. 1953); *Craftint Mfg. Co. v. Baker*, 94 F. 2d 369, 373 (9th Cir. 1938).]

So in determining whether a patented method was anticipated by the prior art, it is immaterial that the apparatus employed in the earlier use was neither as skillfully designed or used, nor as efficient in operation or results as that later devised by the patentee. [*Smith v. Hall*, *supra*, 301 U.S. at 216, n. 8, 232.]

Moreover, as pointed out in *Welsh Mfg. Co. v. Sunware Products Co.*, 236 F. 2d 225 (2d Cir. 1956): "It is proper for the Court to take judicial notice of matters of general knowledge which indicate that a \* \* \* [method] is not new." [236 F. 2d at 226; *Slawson v. Grand St. R. R.*, 107 U.S. 649, 654 (1882).] [164]

It would serve no useful purpose to labor here the detail of a comparison of the essential steps embraced by the cleaning methods disclosed in the prior-art patents involved here, both cited and uncited. Plainly, the patents not cited by the examiner are decidedly more pertinent to the precise art of the claimed invention than those which were cited.

One reads the file wrapper and wonders upon what possible ground the letters in suit issued, even over the prior art cited.

In the language of the Court of Appeals for the Ninth Circuit in *Mettler v. Peabody Eng. Corp.*, supra, 77 F. 2d 56: "The presumption of validity which attends the issuance of letters patent by the patent office is overcome in this case by the clear [undisputed] evidence of anticipation in the prior art which was not cited or considered by the Patent Office when the application for \* \* \* [the] patent was passed on." [77 F. 2d at 58.]

Being anticipated by prior-art patents which were not cited or considered by the patent office in passing on the application for the patent in suit, Letters Patent No. 2,653,116 are invalid; and no fact finder could, within the bounds of reasonableness, find validity here. [See: *Muench-Kreuzer Candle Co., Inc. v. Wilson*, supra, 246 F. 2d [165] 624; *Oriental Foods v. Chun King Sales*, supra, 244 F. 2d 909; *Kwikset Locks, Inc. v. Hillgren*, supra, 210 F. 2d 483; cf. *Syracuse v. Paris*, supra, 234 F. 2d 65.]

Even if it be said that there appears no "strict anticipation" of the patent in suit, and that the method involves some novelty, it nonetheless lacks invention. As Judge Fee stated for the Court in *Stauffer v. Slenderella Systems of California, Inc.*, F. 2d (9th Cir. Nov. 15, 1957): "The advances in the prior art may be such that, although there is no strict anticipation and even though the \* \* \* [methods] involved may not be similar, a trained

mechanic would, if presented with the problem, solve it without difficulty.”

The statute provides that: “A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains.” [35 U.S.C. § 103.]

Where, as here, use of a cleaning process or method is common to many fields, “its application to a new field ordinarily involves no more than ordinary mechanical skill.” [166] [*Welsh Mfg. Co. v. Sunware Products Co.*, *supra*, 236 F. 2d at 226; *Concrete Appliances Co. v. Gomery*, 269 U. S. 177, 185 (1925); *Vandeburgh v. Truscon Steel Co.*, 261 U. S. 6, 15 (1923); *Lovell Mfg. Co. v. Cary*, 147 U. S. 623, 633-634 (1893).]

Nor is invention ordinarily involved “even though changes or modifications are essential to the practical application of the method \* \* \* to the new use \* \* \*” [*International Steel Wool Corp. v. Williams Co.*, *supra*, 137 F. 2d at 346; cf: Reviser’s note to 35 U.S.C. § 101 (1952); *Jungersen v. Ostby & Barton Co.*, 335 U.S. 560 (1949); *Mandel Bros., Inc. v. Wallace*, 335 U.S. 291 (1948); *Sinclair & Carroll Co. v. Interchemical Corp.*, 325 U.S. 327 (1945); *Honolulu Oil Corp. v. Halliburton*, 306 U.S. 550 (1939).]

Clearly, no fact finder could reasonably conclude that patentable novelty subsists in the discovery that an old method used in cleaning railroad tank cars, ship tanks, drums, and radiators can be adapted to the cleaning of airplane fuel tanks.

Here, as in *Dow Chemical Co. v. Halliburton Oil Well Cementing Co.*, supra, 324 U.S. 320: "He who is merely the first to utilize the existing fund of public knowledge for new and obvious purposes must be satisfied with whatever fame, personal satisfaction or commercial success he may be able to [167] achieve. Patent monopolies, with all their significant economic and social consequences, are not reserved for those who contribute so insubstantially to that fund of public knowledge." [324 U.S. at 328.]

The most that can be said of the patent in suit is that the method claimed to constitute invention is but a mere aggregation of steps long known and employed in the fuel-tank cleaning art. It may well be that use of the patentee's method increases efficiency both in labor expended and results obtained. "But perfection of workmanship, however useful or convenient, does not constitute invention." [*Photochart v. Photo Patrol, Inc.*, 189 F. 2d 625, 628 (9th Cir.), cert. denied, 342 U.S. 867 (1951); see *Toledo Pressed Steel Co. v. Standard Parts, Inc.*, 307 U.S. 350, 356 (1939).]

The conjunction or concert of known steps in the fuel-tank cleaning process must contribute something; only when the whole in some way exceeds the sum of its parts is the accumulation of



old methods patentable. [Great Atlantic & Pacific Tea Co. v. Supermarket Equipment Corp., *supra*, 340 U.S. at 152; and see: *Jungersen v. Ostby & Barton Co.*, *supra*, 335 U.S. at 566-567; *Muench-Kreuzer Candle Co. v. Wilson*, *supra*, 246 F. 2d 624; *Oriental Foods v. Chun King Sales*, [168] *supra*, 244 F. 2d at 913; *Schmeiser v. Thomasian*, *supra*, 227 F. 2d at 877; *Kwikset Locks, Inc. v. Hillgren*, *supra*, 210 F. 2d at 486-487.]

To paraphrase the language of *Market St. Cable Ry. v. Rowley*, *supra*, 155 U.S. at 625: If, upon the state of the art as shown to exist by the prior patents, and upon a comparison of the older processes with the method described in the patent in suit, it should appear that the patent claims are not novel, or that the claimed invention is anticipated by the prior art, it becomes the duty of the court to grant summary judgment on the issue of validity. [See *Vermont Structural Slate Co. v. Tatko Bros. Slate Co.*, 233 F. 2d 9 (2d Cir.), cert. denied, 352 U.S. 917 (1956); *Syracuse v. Paris*, *supra*, 234 F. 2d 65; *Bobertz v. General Motors Corp.*, 228 F. 2d 94, 99-100 (6th Cir. 1955), cert. denied, 352 U.S. 824 (1956); *Park-In Theaters, Inc. v. Perkins*, 190 F. 2d 137, 142 (9th Cir. 1951); *Davison Chemical Corp. v. Joliet Chemicals, Inc.*, 179 F. 2d 793 (7th Cir.), cert. denied, 340 U.S. 816 (1950); *Steigleder v. Eberhard Faber Pencil Co.*, 176 F. 2d 604 (1st Cir.), cert. denied, 338 U.S. 893 (1949); *Smith v. General Foundry Mach. Co.*, 174 F. 2d 147, 151 (4th Cir.), cert. denied, 338 U.S. 869 (1949); cf: *Leishman v. Radio Condenser Co.*,



167 F. 2d 890 (9th Cir.), cert. denied, 335 U.S. 891 (1948); *Stuart Oxygen Co. [169] v. Josephian*, 162 F. 2d 857, 859 (9th Cir. 1947).]

Here, it appears as a matter of law from undisputed facts disclosed by the letters and the file wrapper of patent 2,653,116, and the prior-art patents, both cited and non-cited, that the patent in suit is invalid because of "strict anticipation" [35 U.S.C. § 102(b)] or, in any event, for want of patentable novelty. [Id. § 103.]

As Judge Pope observed for the Court in *Leishman v. General Motors Corp.*, 191 F. 2d 522 (9th Cir. 1951), cert. denied, 342 U.S. 943 (1952): "Even if the disclosures of the prior art had fallen short of complete anticipation, yet invention may be negated by such disclosures." [191 F. 2d at 530.] So in the case at bar, even if the disclosures of the non-cited-prior-art patents be said to fall short of complete anticipation, they still serve upon the motion for summary judgment to negative invention, and thus to render invalid the patent in suit since, as has been shown, no presumption of validity can subsist as to the non-cited-prior-art patents.

This alone is sufficient to dispose of the case on the merits. For when, on a motion for summary judgment, "there is no genuine issue as to any material fact" involved in the adjudication of a single issue which is dispositive of [170] the case, "and \* \* \* the moving party is entitled to a judgment as a matter of law" on that single issue, all other issues of fact raised by the parties, however

genuine—such as prior publication, infringement and the like—become as a matter of law immaterial. [See: *McComb v. Southern Weighing & Inspection Bureau*, 170 F. 2d 526, 530 (4th Cir. 1948); *Keehn v. Brady Transfer & Storage Co.*, 159 F. 2d 383, 385 (7th Cir.), cert. denied, 331 U.S. 844 (1947); cf: *Dolgoff v. Kaynar Co.*, 18 F.R.D. 424 (S.D. Cal. 1955).]

For the reasons stated, plaintiff's motion for summary judgment on the issue of validity of the patent in suit will be granted; and the attorneys for plaintiff may lodge with the Clerk within five days findings of fact, conclusions of law and judgment accordingly, to be settled pursuant to local rule 7. [171]

[Endorsed]: Filed December 11, 1957.

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In The United States District Court, Southern  
District of California, Central Division

Civil Action No. 17,387-WM

DELCO CHEMICALS, INC., a corporation,  
Plaintiff,

vs.

CEE-BEE CHEMICAL CO., INC., a corporation;  
et al., Defendants.

**FINDINGS OF FACT, CONCLUSIONS OF  
LAW AND SUMMARY JUDGMENT**

The motion of Plaintiff herein for summary judgment having been heard, the Court, being fully

advised and having filed its Memorandum of Decision on December 11, 1957, makes the following findings of fact and conclusions of law:

### Findings of Fact

1. Plaintiff, Delco Chemicals, Inc., is a Delaware corporation having its principal place of business in the County of Los Angeles, State of California.

2. Defendant, Cee-Bee Chemical Co., Inc., is a California corporation having a regular and established place of business in the City of Los Angeles, County of Los Angeles, State of California, within the Southern District of California, Central Division. [172]

3. This Court has jurisdiction of the parties and of the subject matter of this action.

4. United States letters patent in suit No. 2,653,116 was issued by the Commissioner of Patents of the United States on September 23, 1953, to Defendant Cee-Bee Chemical Co., Inc., as assignee.

5. A bonafide dispute exists between Plaintiff Delco Chemicals, Inc., and Defendant Cee-Bee Chemical Co., Inc., as to the validity of United States Letters Patent in suit No. 2,653,116.

6. There is no genuine issue as to any material fact necessary to the consideration and determination of said motion for summary judgment.

7. United States Letters Patent in suit No. 2,653,116 relates to the cleaning of tanks, its stated object being to remove coatings of sealant material from airplane fuel tanks by the claimed method

or procedure of spraying a suitable solvent against the upper parts of the tank walls, allowing the sprayed solvent and any loosened sealant particles to drain out of the tank by gravity, screening the drained solvent to separate from it any sealant particles and then recirculating the screen solvent to the sprays, after which a water rinse is applied to the tank as is customary in cleaning operations.

8. The file wrapper of the patent in suit discloses that, during prosecution of the application for the patent in suit before the Commissioner of Patents, its subject matter was treated and considered by both the Commissioner of Patents and the applicants for the patent as being within and analogous to the general art of tank cleaning, it being an old practice to remove various sorts of coatings from tanks, such as tank cars and ship tanks, by continuously spraying a recirculated solvent against the tank walls while draining sprayed solvent from the tank along with removed coating particles.

9. The file wrapper of the patent in suit discloses that, of the prior patents cited by the Commissioner of Patents against the application for the patent in suit, the patent directed particularly to tank cleaning which was treated as being the most pertinent was Butterworth Re. 19,374, which discloses the cleaning of ship cargo tanks by continuously spraying solvent against the tank walls, allowing the sprayed solvent and any loosened coating particles to drain by gravity to the bottom of the tank from which point the solvent is picked up by a pump and returned to the sprays after being



passed through a settling tank to separate the particles from the solvent.

10. United States Letters Patent to Foster, No. 1,141,243, cited by the Patent Office against the application for the patent in suit, discloses that it is old to apply soapy or water-rinsable emulsifying solution to any surface being cleaned.

11. The patent in suit contains eight claims, of which Claim 5 reads as follows:

“The method of removing the sealant from within an aircraft integral fuel tank, which comprises impinging a spray of solvent against the sealant to remove same, washing free sealant from the tank by free solvent, screening out sealant from the solvent, [174] recirculating the latter as a spray against remaining sealant, and, when the sealant is substantially removed, applying rinse water to remove solvent and loosened sealant remaining in the tank.”

Claim 1 of the patent differs from Claim 5 in that it specifies that the tank is sealed while being cleaned, specifies that the tank is given a soapy spray before being rinsed and specifies that the rinse water is sprayed at a “higher pressure. Claim 2 of the patent in suit is substantially the same as Claim 1 except that it does not specify that the tank is sealed while being cleaned. Claim 3 of the patent in suit is substantially like Claim 2 except that it specifies that the solvent is sprayed at a pressure of 30 to 90 pounds, that the solvent is heated 60° to 120° F., and that the rinse water



is applied at approximately 300 pounds per square inch. Claim 4 of the patent in suit is substantially like Claim 5 except that it specifies that the solvent is sprayed against the bulkheads in the tank and omits reference to any rinsing operation. Claim 6 is substantially like Claim 5 except that it calls for rinsing at a higher pressure. Claim 7 of the patent in suit is substantially like Claim 6 except that it specifies that rinse water is applied at approximately 300 pounds per square inch. Claim 8 of the patent in suit is substantially the same as Claim 6 except that it omits reference to any rinsing operation. However, the specification of the patent in suit fails to attribute any unconventional or unexpected significance to sealing the tank while it is being cleaned, or to heating the solvent to any particular temperature, or to spraying the solvent or rinse water at any particular pressure, or to spraying the bulkheads of the tank, or to applying soap before rinsing and such details add nothing of patentable significance.

12. The Commissioner of Patents failed to cite against the application for the patent in suit the most pertinent prior art, [175] including the following prior United States patents:

Butterworth .....	2,018,757
Butterworth .....	2,045,752
Land .....	1,666,015
Jensen .....	1,730,656
Olsson .....	2,065,462
Robinson .....	1,701,824
Court .....	2,245,554

which show the method of the patent in suit to be old, including the draining of the sprayed solvent from the tank and screening it before recirculating it.

13. Said prior Butterworth 2,018,757 discloses, in Fig. 3 of its drawing, the cleaning of railroad tank cars by continuously pumping heated solvent from a supply tank to sprays in the upper part of the tank car, allowing the sprayed solvent and all removed coating particles to drain by gravity over the lower parts of the walls and from the bottom of the tank car, from whence it is passed through a weir or screen back into the supply tank from which it is recirculated.

14. Said Land 1,666,015 discloses the cleaning of a tank car by spraying solvent into the upper part of the tank car, draining the sprayed solvent and any removed coating particles through the bottom of the tank, recirculating the drained solvent and applying a water rinse to the tank car. The tank is shown as being sealed while the solvent is being sprayed.

15. Said Butterworth 2,045,752 discloses the cleaning of a tank by spraying heated solvent into the tank, draining the sprayed solvent and any removed coating particles through the bottom of the tank, passing the drained solvent and its coating particles through a "settling tank or clarifier" and then recirculating it to the sprays. The patent also discloses giving the tank a steam bath, and shows the tank as being sealed. [176]

16. Said Olsson 2,065,462 discloses spraying the

solvent against the bulkheads of the tank being cleaned, as specified in Claim 4 of the patent in suit.

17. Said Jensen 1,730,658 discloses the cleaning of drums by spraying solvent from a supply tank into the inverted drums, draining the sprayed solvent and any removed coating back into the supply tank by gravity, and then recirculating the solvent to the sprays.

18. Said Robinson 1,701,824 shows the cleaning of radiators by forcing heated solvent from a supply tank through the radiator, and back into the supply tank through a screen, and then recirculating the screened solvent.

19. Said Court 2,245,554 discloses a method and apparatus for clearing coke deposits from the reaction chambers of petroleum cracking plants utilizing high-pressure water sprays directed against the walls of the chamber to dislodge the solid materials, the water and dislodged solid material draining gravitationally from the chamber into a separator which utilizes a screen and a settling basin to separate out solid materials, the water, after passing through the separator, being pumped to the spray heads in the chamber, the water thus being recirculated and all solid particles being removed.

20. Extrinsic evidence is not needed to explain or evaluate the aforesaid most pertinent prior art and its applicability to the subject matter of the patent in suit.

21. In the patent in suit, the various steps or procedures set forth as constituting the patented

method do not produce any result which they do not produce in the prior art, or any unexpected result, and do not produce, in their aggregation, any result greater than the sum of their separate results, or any result patentably different from the result which, in their aggregation, they produce in the prior art. [177]

22. There is no patentable novelty in the discovery that an old method used in cleaning railroad tank cars, ship tanks, drums and radiators, can be used to clean airplane fuel tanks.

23. The patent in suit and each of its claims are completely anticipated by the prior art.

24. The patent in suit and each of its claims are lacking in invention over the prior art.

25. The patent in suit and each of its claims are devoid of patentable novelty.

26. The "Memorandum of Decision" filed December 11, 1957 is hereby incorporated by reference herein.

### Conclusions of Law

1. The patent in suit is owned by Defendant Cee-Bee Chemical Co., Inc.

2. Any presumption that the patent in suit is valid does not subsist as to the pertinent prior art which was not cited nor considered by the Patent Office.

3. There being no substantial dispute of fact as to the contents of the patent in suit, or the file wrapper, or the prior art patents, both cited and uncited; and no subsisting presumption of validity as to the pertinent prior art which was not cited

by the Patent Office; and extrinsic evidence not being required for the purposes of explanation, the questions of anticipation and want of invention, and hence of validity, are questions of law.

4. The patent in suit, and each of its claims, are invalid and void, for want of invention over the prior art.

5. Plaintiff is entitled to judgment declaring United States Letters Patent in suit No. 2,653,116 invalid and void, dismissing the counterclaim of Defendant, and for Plaintiff's taxable costs.

### Judgment

In accordance with the foregoing Findings of Fact and Conclusions of Law, it is Ordered, Adjudged and Decreed:

1. Defendant Cee-Bee Chemical Co., Inc., is the owner of United States Letters Patent No. 2,653,116. [178]

2. United States Letters Patent in suit No. 2,653,116 and each of the claims thereof are invalid and void.

3. The counterclaim of defendant Cee-Bee Chemical Co., Inc., is hereby dismissed.

4. Plaintiff shall recover its taxable costs herein in the amount of \$169.25.

Dated at Los Angeles, California, this 27th day of December, 1957.

/s/ WM. C. MATHES,

United States District Judge.

Acknowledgment of Service Attached. [179]

[Endorsed]: Filed Dec. 27, 1957. Entered Dec. 30, 1957.



[Title of District Court and Cause.]

### NOTICE OF APPEAL

Notice is hereby given that Cee-Bee Chemical Co., Inc., the defendant above-named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Summary Judgment entered in this action on December 11, 1957.

Los Angeles 14, California.

C. G. STRATTON,  
LOUIS M. WELSH,

/s/ By C. G. STRATTON,  
Attorneys for Cee-Bee  
Chemical Co., Inc. [180]

Affidavit of Service by Mail Attached. [181]

[Endorsed]: Filed Jan. 8, 1958.

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[Title of District Court and Cause.]

### DESIGNATION BY APPELLANT CEE-BEE CHEMICAL CO., INC., OF CONTENTS OF RECORD ON APPEAL [182]

Appellant Cee-Bee Chemical Co., Inc., designates the following portions of the record to be contained in the Record on Appeal in this action:

(1) Complaint for Declaratory Judgment of Patent Invalidity and Non-Infringement, Unfair Competition, and Damages and Injunctive Relief Under Sherman and Clayton Anti-Trust Laws.

(2) Amended Answer to Complaint and Counterclaim.

(3) Minute Order of December 13, 1954, granting Motion to Serve Amended Answer to Complaint and Counterclaim.

(4) Answer to Counterclaim of Defendant Cee-Bee Chemical Co., Inc.

(5) Stipulation and Order for Dismissal Without Prejudice of Plaintiff's Second and Third Causes of Action.

(6) Notice of Motion and Motion for Summary Judgment, page 1; page 2, lines 1 to 20, inclusive. Indicate that legal argument, page 2, lines 22 to 32, inclusive; and pages 3 and 4, omitted.

(7) Affidavit of George H. Boeck, dated [183] February 20, 1957.

(8) Exhibit "K" attached to said Boeck affidavit.

(9) Exhibit "L" attached to said Boeck affidavit.

(10) Exhibit "M" attached to said Boeck affidavit.

(11) Defendant's Notice re Plaintiff's Motion for Summary Judgment.

(12) Copyright Office Certificate dated March 13, 1957.

(13) Reporter's Transcript of Proceedings in this case, dated February 11, 1957.

(14) Reporter's Transcript of Proceedings of September 13, 1954 in the case of Clarence P. Taylor, plaintiff, vs. Keuffel & Esser Co., of N. Y., a corporation, et al., defendants, Civil No. 15,820 WM

in the United States District Court, Southern District of California, Central Division.

(15) Affidavit of Vesta M. Nelson, dated April 1, 1957.

(16) Affidavit of Claud D. Black, dated April 1, 1957.

(17) Exhibit 11 attached to said Black affidavit.

(18) Affidavit of James L. Jackson, dated March 25, 1957.

(19) Affidavit of William Douglas Sellers, dated March 11, 1957.

(20) Exhibits 9 and 10 attached to said Sellers affidavit.

(21) Affidavit of Keith R. Whitcomb, dated March 28, 1957.

(22) Affidavit of Edward W. Giddings, dated March 29, 1957 (without exhibits).

(23) Memorandum of Decision filed December 11, 1957.

(24) Findings of Fact, Conclusions of Law, and Summary Judgment, dated December 30, 1957.

(25) Notice of Appeal.

(26) Statement of Points on which appellant intends to rely on appeal, served herewith.

(27) This Designation.

(28) Soft copy of the patent in suit.

(29) The following parts of the file wrapper of the patent in suit: all correspondence between the Patent Office and the attorney for the applicant from July 12, 1950 to July 22, 1954, including all affidavits filed therein.

(30) Soft copies of the following patents cited

by the Examiner during the prosecution of the patent in suit through the Patent Office: [185]

Name	Number	Issue Date
(a) Butterworth	Re. 19,374	Nov. 21, 1934
(b) Foster	1,141,243	June 1, 1915
(c) Gray	1,628,141	May 10, 1927
(d) Houpt	1,892,950	Jan. 3, 1933
(e) McFadden	2,092,321	Sept. 7, 1937
(f) Paulson et al	2,123,434	July 12, 1938
(g) Jaffa	2,442,272	May 25, 1948
(h) Brady	2,458,333	Jan. 4, 1949

(31) Soft copies of the following patents not cited by the Examiner during the prosecution of the patent in suit through the Patent Office:

Name	Number	Issue Date
(a) Butterworth	2,018,757	Oct. 29, 1935
(b) Butterworth	2,045,752	June 30, 1936
(c) Land	1,666,015	Apr. 10, 1928
(d) Jensen	1,730,658	Oct. 8, 1929
(e) Olsson	2,065,462	Dec. 22, 1936
(f) Robinson	1,701,824	Feb. 12, 1929
(g) Court	2,245,554	June 17, 1941

(32) The following portions of the deposition of Sydney G. Thornbury, taken March 7, 1957:

(a) Page 2, lines 1-3, inclusive; lines 13-24, inclusive;

(b) Page 3, lines 12-20, inclusive;

(c) Page 4, lines 4-8, inclusive; lines 12-18, inclusive; [186]

- (d) Page 5, line 5 to the period in line 17;
- (e) Page 6, lines 16-26, inclusive;
- (f) Page 7, lines 7-13, inclusive;
- (g) Page 7, line 17 to page 8, line 3 (to the period);
- (h) Page 8, line 10, starting with "It seemed to me" to the period in line 16;
- (i) Page 9, line 20 to page 10, line 12, inclusive;
- (j) Page 11, lines 6-15, inclusive; line 19 to the period in line 24;
- (k) Page 12, line 2, starting with "I have never" to line 4, inclusive;
- (l) Page 13, lines 6-13, inclusive; lines 17-19, inclusive;
- (m) Page 13, line 23 to the period in line 8, page 14;
- (n) Page 14, line 15 to page 15, line 20;
- (o) Page 16, lines 17-21, inclusive;
- (p) Page 22, line 26 to page 23, line 25;
- (q) Page 26, lines 10-15, inclusive;
- (r) Page 27, lines 3-4, inclusive; lines 9-11, inclusive; lines 16-20, inclusive; lines 24-26, inclusive;
- (s) Page 28, lines 1-22, inclusive;
- (t) Page 29, lines 3-12, inclusive;
- (u) Page 35, line 19 to page 36, line 11, inclusive.

(33) The following portions of the deposition of Robert C. Bear, taken September 12, 1955: [187]

- (a) Page 2, 8th line, to page 3, 17th line, inclusive;
- (b) Page 11, last line, to page 12, 7th line, inclusive;



- (c) Page 14, 8th to 14th lines, inclusive;
- (d) Page 15, first to 16th lines, inclusive;
- (e) Page 19, 12th to 23rd lines, inclusive;
- (f) Page 20, 10th to 25th lines, inclusive;
- (g) Page 21, 5th to 14th lines, inclusive;
- (h) Page 25, 20th line (commencing "Q. First, I shall ask you,"), to page 26, 19th line, inclusive;
- (i) Page 37, 13th line, to page 38, 10th line.

(34) The following portions of the deposition of Thomas H. Edgin, taken September 17, 1955:

- (a) Page 3, first to 18th lines, inclusive;
- (b) Page 11, next to last line, to page 12, 19th line, inclusive;
- (c) Page 13, 15th line, to page 14, 21st line, inclusive;
- (d) Page 15, 9th to 25th lines, inclusive;
- (e) Page 16, 20th line, to page 17, 11th line, inclusive;
- (f) Page 17, 23rd line, to page 18, 8th line, inclusive;
- (g) Page 18, 15th to 24th lines, inclusive (and including Defendants' Exhibit A therein identified);
- (h) Page 25, 5th to 20th lines, inclusive; [188]
- (i) Page 27, 10th to 22nd lines, inclusive.

(35) The following portions of the deposition of Charles R. Ursell, taken January 29, 1957:

- (a) Page 4, lines 1 to 25, inclusive;
- (b) Page 6, lines 9 to 15, inclusive;
- (c) Page 7, lines 14 to 18, inclusive;
- (d) Page 8, lines 1 to 5, inclusive;
- (e) Page 11, lines 8 to 12, inclusive;
- (f) Page 12, lines 20 to 24, inclusive;

- (g) Page 15, line 23, to page 16, line 2, inclusive;
- (h) Page 17, lines 2 to 8, inclusive;
- (i) Page 17, line 22, to page 18, line 1 inclusive;
- (j) Page 18, lines 5 to 10, inclusive;
- (k) Page 18, line 20, to page 19, line 2, inclusive;
- (l) Page 19, lines 6 to 10, inclusive;
- (m) Page 19, line 15, to page 20, line 2, inclusive;
- (n) Page 20, lines 11 to 19, inclusive;
- (o) Page 21, lines 2 to 11, inclusive;
- (p) Page 22, lines 6 to 12, inclusive;
- (q) Page 25, line 9, to page 26, line 13, inclusive;
- (r) Page 26, line 22, to page 27, line 5, inclusive;
- (s) Page 27, line 14, to page 28, line 3, inclusive.

Dated at Los Angeles, California, this 28th day of January, 1958.

/s/ C. G. STRATTON,

Of Counsel for Appellant. [189]

Affidavit of Service by Mail Attached. [190]

[Endorsed]: Filed Jan. 30, 1958.

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[Title of District Court and Cause.]

STATEMENT BY APPELLANT CEE-BEE  
CHEMICAL CO., INC. OF POINTS ON  
APPEAL [191]

The points upon which appellant intends to rely on this appeal are as follows:

1.

The Court erred in not dismissing the plaintiff's complaint.

2.

The Court erred in not entering judgment in favor of defendant upon its counterclaim.

3.

The Court erred in granting plaintiff's Motion for Summary Judgment.

4.

The Court erred in entering judgment that the patent in suit, No. 2,653,116, is, and each of the claims thereof are, invalid and void.

5.

The Court erred in dismissing defendant's counterclaim.

6.

The Court erred in entering judgment for plaintiff's [192] taxable costs herein.

7.

The Court erred in finding that no genuine issue as to any material fact existed in connection with the determination of plaintiff's Motion for Summary Judgment.

8.

The Court erred in finding that a soapy solution and a water-rinsable, solvent-miscible material are equivalent.

9.

The Court erred in finding that claims 1 to 3, inclusive, of the patent in suit specify a "soapy spray" for a tank before being rinsed, and that "soap" was applied before rinsing.

10.

The Court erred in finding that the Commissioner of Patents failed to cite against the application for the patent in suit, the most pertinent prior art.

11.

The Court erred in finding that the prior art which the Commissioner of Patents failed to cite against [193] the application for the patent in suit shows the method of the patent in suit to be old.

12.

The Court erred in finding that in Fig. 3 of Butterworth 2,018,757 the material is passed "through" a weir "or screen."

13.

The Court erred in not applying said prior art specifically to the claims of the patent in suit.

14.

The Court erred in finding that Court patent 2,245,554 has any bearing upon the patent in suit.

15.

The Court erred in finding that extrinsic evidence is not needed to explain or evaluate the prior art

cited by the plaintiff-appellee in this case, and its applicability to the subject matter of the patent in suit.

## 16.

The Court erred in finding that the patent in suit (a) does not produce any result not found in the prior art; (b) does not produce any unexpected result; and (c) [194] does not produce any result greater or patentably different than the sum of the various steps or procedures of the prior art.

## 17.

The Court erred in finding that the patent in suit merely covered an old method of cleaning railroad tank cars, ship tanks, drums, or radiators.

## 18.

The Court erred in finding that the patent in suit, and each of its claims, is anticipated by the prior art, "completely" or otherwise.

## 19.

The Court erred in finding that the patent in suit, and each of its claims, lacks invention over the prior art, and is devoid of patentable novelty.

## 20.

The Court erred in concluding that there was no substantial dispute of fact as to any of the prior art patents.

## 21.

The Court erred in concluding that questions of [195] anticipation are questions of law.



22.

The Court erred in concluding that questions of want of invention are questions of law.

23.

The Court erred in concluding that questions of validity are questions of law.

24.

The Court erred in not holding that the depositions of Sydney G. Thornbury, Robert C. Baer, Thomas Edgin and C. R. Wisell raise issues of fact as to plaintiff-appellee's Motion for Summary Judgment.

25.

The Court erred in its interpretation of the file wrapper of the patent in suit.

26.

The Court erred in not holding that the prior art cited in paragraph 12 of the Findings herein is no closer than, if as close as, the prior art cited by the Examiner during the prosecution of the application for the present patent through the Patent Office.

27.

The Court erred in not holding that there is a presumption of validity of the patent in suit over said prior art because it is no closer than that cited by said Examiner.

28.

The Court erred in not holding that the prior art

fails to show the step in the present patented method of applying a water-rinsable, solvent-miscible material.

## 29.

The Court erred in deciding on a Motion for Summary Judgment a disputed question of fact in connection with the nature, construction and operation of the weir shown and described in Butterworth patent 2,018,757.

## 30.

The Court erred in holding that the weir of Butterworth patent 2,018,757 is the equivalent of a screen, in the face of the issue of fact raised by defendant-appellant, to wit, that the nature and speed of travel of the solvent-soaked sealant would cause it to pass over a weir but be caught by a screen. [197]

## 31.

The Court erred in taking "judicial notice of matters of general knowledge" without stating or showing what such matters were.

## 32.

The Court erred in holding that "no fact finder could, within the bounds of reasonableness, find validity" in the Letters Patent No. 2,653,116, in suit here.

## 33.

In apparently recognizing that there is "no 'strict anticipation' " of the patent in suit, and that there is "some novelty" in same, the Court erred in deciding on a Motion for Summary Judgment the dis-

puted question of fact of whether “a trained mechanic” would have solved the present problem “without difficulty” “at the time the invention was made.”

34.

The Court erred in holding that the present patented “cleaning process or method is common to many fields.”

35.

The Court erred in holding that the present patented method was “obvious” to one skilled in the art. [198]

36.

The Court erred in holding that the patented method “is but a mere aggregation of steps long known and employed in the fuel-tank cleaning art.”

37.

The Court erred in holding that all the steps of the patented method are “known steps.”

38.

The Court erred in not holding that the patent in suit covers an unobvious method that produces a new and useful result over the prior art cited.

C. G. STRATTON,  
LOUIS M. WELSH,

/s/ By C. G. STRATTON,

Attorneys for Appellant Cee-  
Bee Chemical Co., Inc. [199]

Affidavit of Service by Mail Attached. [200]

[Endorsed]: Filed Jan. 30, 1958.

[Title of District Court and Cause.]

COUNTER-DESIGNATION BY APPELLEE,  
DELCO CHEMICALS, INC., OF ADDI-  
TIONAL CONTENTS OF RECORD ON  
APPEAL

Appellee, Delco Chemicals, Inc., under and pursuant to Rule 75(a) F.R.C.P., hereby designates the following additional portions of the record for inclusion in the record on appeal in this action.

1.

The affidavit of Walter P. Huntley, dated February 20, 1957, attached to Plaintiff's Motion for Summary Judgment, together with Exhibits B, E, F, G, H, I, and J, attached thereto, and including also the annexed affidavit of John M. Lee dated October 25, 1954, together with the exhibits thereto annexed, numbered 6 through 12. [201]

2.

The following portions of the deposition of Sidney G. Thornbury, taken March 7, 1957:

- (a) Page 4, line 19, to page 5, line 4.
- (b) Page 7, lines 1 to 6, inclusive.
- (c) Page 11, lines 16 to 18, inclusive.
- (d) Page 11, line 25, to page 12, line 2.
- (e) Page 12, lines 12 to 15, inclusive.
- (f) Page 13, lines 1 to 5, inclusive.
- (g) Page 16, lines 8 to 16, inclusive.
- (h) Page 18, line 15, to page 19, line 6.
- (i) All of page 20.

- (j) All of page 21.
- (k) Page 22, lines 1 to 7, inclusive.
- (l) Page 24, lines 13 to 22, inclusive.
- (m) Page 28, line 23 to page 29, line 2.
- (n) Page 30, line 19, to page 31, line 7.
- (o) Page 31, lines 17 to 25, inclusive.
- (p) Page 32, lines 2 to 18, inclusive.
- (q) Page 33, line 12, to page 34, line 6.
- (r) Page 37, line 18, to page 38, line 2.

## 3.

The following portions of the deposition of Charles R. Ursell, taken January 29, 1957:

- (a) Page 15, lines 12 to 17, inclusive.
- (b) Page 16, lines 5 and 6.
- (c) Page 45, lines 13 to 21, inclusive. [202]

Dated at Los Angeles, California, this 11th day of February, 1958.

FULWIDER, MATTINGLY &  
HUNTLEY,

ROBERT W. FULWIDER,  
WALTER P. HUNTLEY,  
JOHN M. LEE AND  
JOHN A. WEYL,

/s/ By WALTER P. HUNTLEY,  
Attorneys for Appellee. [203]

Affidavit of Service by Mail Attached. [204]

[Endorsed]: Filed Feb. 11, 1958.



[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 204, inclusive, containing the original:

Complaint

Affidavit of John M. Lee

(Copy) Minute Order of Court, 12/13/54

Amended Answer to Complaint and Counterclaim

Answer to Counterclaim of Defendant Cee-Bee Chemical Co. Inc.

Stipulation and Order for Dismissal without prejudice of Plaintiff's Second and Third Causes of Action

Notice of Motion and Motion for Summary Judgment, with supporting Affidavits, Exhibits, File Wrapper, etc.

Defendant's Notice Re Plaintiff's Motion for Summary Judgment

Reporter's Transcript of Proceedings had on 9/13/54 in Case No. 15,820-WM Clarence P. Taylor v. Keuffel and Esser Co., etc., (attached to "Defendant's Notice Re Plaintiff's Motion for Summary Judgment")

Memorandum of Decision

Findings of Fact, Conclusions of Law and Summary Judgment

Notice of Appeal

Designation by Appellant Cee-Bee Chemical Co. Inc. of Contents of Record on Appeal

Statement by Appellant Cee-Bee Chemical Co. Inc. of Points on Appeal

Counter-Designation by Appellee Delco Chemicals Inc. of Additional Contents of Record on Appeal

B. Depositions of: Sydney G. Thornbury; Robert C. Bear; Thomas H. Edgin; and Charles R. Ursell.

C. One volume of Reporter's Transcript of Proceedings had on: February 11, 1957.

I further certify that my fee for preparing the foregoing record, amounting to \$2.00 has been paid by appellant.

Dated: February 13, 1958.

[Seal]                      JOHN A. CHILDRESS,  
                                    Clerk,  
                                    /s/ By WM. A. WHITE,  
                                    Deputy Clerk.

[Title of District Court and Cause.]

DEPOSITION OF ROBERT C. BEAR

Washington, D. C.

Monday, September 12, 1955

\* \* \* \* \*

ROBERT C. BEAR

called as a witness by counsel for defendant, and having first been duly sworn, was examined and testified as follows:

Direct Examination

Q. (By Mr. Welsh): Will you please state your full name?      A. Robert C. Bear.

Q. Where do you live, Mr. Bear?

A. 1138 Linden Avenue, Takoma Park, Maryland.

Q. Is Takoma Park, Maryland, a suburb of Washington, D. C.?      A. Yes.

Q. By whom are you employed?

A. Capital Airlines, Washington National Airport, Washington, D. C.

Q. How long have you been employed by Capital Airlines?      A. Nine years.

Q. In what capacity or capacities have you been employed [2]\* by that airline?

A. As a mechanic, instructor, and foreman.

Q. What is your present capacity with Capital Airlines?      A. Assistant foreman.

Q. Assistant foreman of any particular depart-

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\* Page numbers appearing at top of page of Original Deposition.

(Deposition of Robert C. Bear.)

ment?           A. The fuel tank repair department.

Q. Now, who is the foreman of that department?

A. There isn't any foreman of that department. I would be.

Q. Then, practically speaking, you are the foreman of the fuel tank repair section; is that correct?

A. That is right.

Q. As foreman of the fuel tank repair section, what are your duties generally?

A. To perform all maintenance and overhauls on the fuel tanks of the Douglas C-54s, DC-4s, and Lockheed Constellation aircraft. [3]

\* \* \* \* \*

Q. At the time you used the fill-soak-and-drain method, [11] were you aware of any disadvantages in that method of procedure?

A. Yes, we were.

Q. Could you, in general, enumerate some of those disadvantages?

A. The one disadvantage was the amount of material needed to accomplish this procedure. [12]

\* \* \* \* \*

Q. Now, in addition to the fact that the fill-soak-and-drain method consumed such a quantity of stripping chemical, were there any other disadvantages that were apparent to you at the time you were using it?

A. Well, the terrible odor that is given off from this material caused other workmen around the

(Deposition of Robert C. Bear.)

hangars to be very, very dissatisfied with working in that hangar. [14]

\* \* \* \* \*

Q. Now, in addition to that, can you think of any other disadvantage that was apparent to you at the time you were using this fill-soak-and-drain method?

A. Well, another disadvantage is that this material is not light per gallon. I don't exactly remember the pounds per gallon that it weighs, but an airplane with 1,100 gallons of it in one side of the wing creates a hazard to this extent: that it throws the airplane slightly off balance and you are not able to have any other personnel working on the aircraft at that time, due to the unsafe condition that is presented there.

Q. During the process of stripping the sealant off of the inside of the tank when using the fill-soak-and-drain method, were you able to have other operations being performed to the aircraft?

A. No. [15]

\* \* \* \* \*

Q. (By Mr. Welsh): Did the Cee-Bee process of stripping the inside of integral fuel tank wings through recirculation ever come to your attention?

A. Yes, it did.

Q. When? A. In late 1950.

Q. I will show you a photostatic copy of a purported patent No. 2,653,116, issued to K. R. Whitcomb, et al., and ask you to please observe Figure 1.

Does Figure 1 represent the Cee-Bee recirculat-



(Deposition of Robert C. Bear.)

ing process that came to your attention in 1950?

A. Yes. [19] \* \* \* \* \*

Q. Now, at the time this method first came to your attention, did you have any resistance to it?

A. Yes, I did.

Q. Would you please explain why?

A. Well, I was skeptical of it, as I was skeptical of all fuel tank materials and methods, because in the past everybody was trying to get a new method and a better method, and none of them were any good; so any time a new method came up, you were always skeptical of it until you would see the thing in operation and it proved itself.

Q. Now, did you, on behalf of your employer, Capital Airlines, make any investigation of this Cee-Bee recirculating method?

A. Yes, I did. I went to Pacific Airmotive, in Chino, California, in September of 1951, and observed the working of this machine on C-54 aircraft out there. [20]

\* \* \* \* \*

Q. (By Mr. Welsh): Then, subsequent to that, what did you do, if anything, in connection with the Cee-Bee method?

A. Well, we ordered the Cee-Bee Chemical Company to deliver us one of their machines, and their material, so we could start operation in October of 1951 on our C-54 aircraft overhaul.

Q. Did you, in fact, use the Cee-Bee method on any aircraft subsequent to that time? In other words, after you ordered it?

(Deposition of Robert C. Bear.)

A. Yes, we did. [21]

\* \* \* \* \*

Q. First, I shall ask you, from your experience in desealing aircraft, both using the Cee-Bee method and the fill-and-drain method, and from the experiments which you conducted, can you tell us what the average elapsed time is in desealing a DC-4 aircraft with four tanks by the Cee-Bee method?

A. That would be 55 hours, average. [25]

Q. What would the average time consumed be, using the fill-and-drain method?

A. About 192 hours.

Q. Approximately, on the average, how many man hours are consumed in using the Cee-Bee method to desal? A. About 200.

Q. Approximately how many man hours are consumed in using the fill-and-drain method to desal? A. About 800, anyway.

Q. How many gallons of stripping chemical are you unable to use again if the Cee-Bee process is employed? A. About 250 gallons.

Q. This is per aircraft, all of this?

A. Per aircraft, yes.

Q. How many gallons are you unable to use again—— A. Approximately——

Q. Wait a minute.

——should you use the fill-soak-and-drain method?

A. Approximately 1,200 gallons. [26]

\* \* \* \* \*

(Deposition of Robert C. Bear.)

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A. Yes. [19] \* \* \* \* \*

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Q. Did you, in fact, use the Cee-Bee method on any aircraft subsequent to that time? In other words, after you ordered it?

(Deposition of Robert C. Bear.)

A. Yes, we did. [21]

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A. Per aircraft, yes.

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Q. Wait a minute.

——should you use the fill-soak-and-drain method?

A. Approximately 1,200 gallons. [26]

\* \* \* \* \*

(Deposition of Robert C. Bear.)

Q. Could you list for us some of the advantages of the Cee-Bee recirculating spray method, compared to the fill-and-drain method?

A. Well, number one, you don't have to have as large a quantity of material on hand.

Number two, it only requires one man to operate the machine while it is in operation, and your safety hazard is pretty great, because you can work other men on the aircraft while it is in operation.

And your health standpoint from fumes is less in the recirculation or recirculating method.

And as a safety factor, to me, we don't have the hazard of this material or chemical dripping down on people underneath [37] the wing, or walking underneath the wings. It doesn't have to be roped off to keep men away from there.

Q. Safety for the employees you are talking about now?      A. Yes.

Q. May I ask you in connection with the hand-picking whether there is an advantage or not in connection with the Cee-Bee method?

A. Well, there is considerably less hand-picking with the Cee-Bee method than there is with the fill-and-drain method. [38]

\* \* \* \* \*

[Endorsed]: Filed Sept. 20, 1955.



[Title of District Court and Cause.]

DEPOSITION OF THOMAS H. EDGIN

Oklahoma City, Oklahoma

September 17, 1955

\* \* \* \* \*

THOMAS H. EDGIN

being by me first duly sworn to tell the whole truth  
as hereinafter certified, testified as follows:

Direct Examination

Q. (By Mr. Welsh): Will you please state your  
full name? A. Thomas H. Edgin.

Q. Where do you live, Mr. Edgin?

A. 2503 South Central, Oklahoma City, Oklahoma.

Q. What is your business or occupation, sir?

A. I am a mechanical engineer.

Q. And by whom are you employed?

A. Tinker Air Force Base.

Q. That is the United States Air Force, is it?

A. Yes, sir.

Q. How long have you been associated with the  
United States Air Force?

A. Thirteen years and three months. [3]\*

\* \* \* \* \*

Q. Now, the purpose of applying this sealant  
material is what, sir? [11]

A. To prevent aircraft fuel tanks from leaking.

Q. And is it necessary once this material is

---

\* Page numbers appearing at top of page of Original Deposition.

(Deposition of Thomas H. Edgin.)

applied to take it off again, or does it stay on there for the life of the aircraft?

A. It stays on until the aircraft develops sufficient leaks it no longer is practical to make spot repairs.

Q. And then what must be done?

A. The sealant material must be removed from the airplane and replaced.

Q. Now, back in 1946 and '47, did your work require you to supervise the desealing operation, or the operation conducted to take the sealant off of the wings? A. Yes, sir.

Q. And what method or methods did you use in order to deseal the integral fuel tanks at that time?

A. At that time there was two methods for local spot repairs and hand work was accomplished, and when aircraft with more extensive leaking the aircraft was returned for what we call fill and drain desealing. [12]

\* \* \* \* \*

Q. Now, when you use this fill and drain method, do you encounter any particular problems?

A. Yes, we did. It was difficult to use due to the conditions in which the people that had to accomplish the work had to work, and after the airplane had soaked for its soak period of time the access doors were removed and it was necessary for people to get inside the aircraft wing and hand-remove the deposits that were left from the soak period, and it was very hazardous, if you got it on your hands it would burn, or if you got it in your eyes or nose or

(Deposition of Thomas H. Edgin.)

mouth it would be more detrimental to people, and it was toxic, and the [13] safety equipment the people were required to wear was very bundlesome and it cut down on the speed with which the working people could work.

Q. Were these various problems which you recited sufficiently great that there was work being done to attempt to find a better method, if you know?      A. Yes.

Q. What was being done at that time to eliminate these problems?

A. Well, numerous trial and error approaches were made; however, none of them that we made were too effective.

Q. Did any of them come to your attention that were effective?

A. In the early part of 1952, there were two chemical companies brought it to our attention that they had a system which was much better, faster and cheaper than the method that we were using.

Q. And before then had you encountered any methods for doing this job that eliminated many, at least, of the problems that you have recited?

A. No. [14]

\* \* \* \* \*

Q. Now, when the recirculating spray system was first brought to your attention, what was your reaction to that?

A. I was dubious as to its capability.

Q. Why were you dubious?

(Deposition of Thomas H. Edgin.)

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(Deposition of Thomas H. Edgin.)

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A. No. [14]

\* \* \* \* \*

Q. Now, when the recirculating spray system was first brought to your attention, what was your reaction to that?

A. I was dubious as to its capability.

Q. Why were you dubious?



(Deposition of Thomas H. Edgin.)

A. We had had past experiences with not too good results or no improvement.

Q. You mean that other persons had offered possible solutions?

A. We had tried it ourselves to improve the situation with very little positive results.

Q. Now, Mr. Edgin, I show you what purports to be a true copy of the Figures 1 and 2 of the Patent in suit, No. 2,653,116, and ask you whether or not that generally describes or graphically illustrates the recirculating spray system that you have just referred to?

A. The basic principles in this drawing are the same which I referred to. [15]

\* \* \* \* \*

Q. Now, did you determine to make any tests using these circulating spray systems, the one proposed by Turco and the one proposed by Cee-Bee?

A. Yes.

Q. And did you, in fact, make any tests?

A. We made comparative tests of both systems against [16] our own fill and drain system.

Q. In making those tests, did you record the results therefrom?           A. Yes.

Q. And did you make an original report based upon the test of your personal observations?

A. Yes.

Q. Could you please tell us where that original report is?

A. It is filed at Tinker Air Force Base.

Q. Did you bring it with you today?

(Deposition of Thomas H. Edgin.)

A. No, I did not. \* \* \* \* \*

Q. Did you at the time you made your original report, make any copies thereof which were sent to any other agencies? A. Yes. [17]

Q. And among others, did you send a copy to the Cee-Bee Chemical Company? A. Yes.

Q. I show you, Mr. Edgin, what purports to be a copy of your report and ask you whether or not it is in all respects a true and correct copy of the original report filed with the Government?

A. Yes, it is.

\* \* \* \* \*

Q. Alright, I would like to ask that this document to which we have been referring, the copy of the report, be marked as the defendants' exhibit first in order for the purposes of this deposition.

Mr. Fellers: To which the plaintiff objects as being incompetent, irrelevant and immaterial, and not the best evidence.

(The instrument produced and identified is now by the Notary marked for identification as Defendants' Exhibit A.) [18]

[See page 183.]

\* \* \* \* \*

Q. Now, sir, if you will, turn to page 4 of Defendants' Exhibit A and tell me what that page contains?

A. It contains other important advantages of the Cee-Bee Chemical Company's process.

Q. And how many advantages have you listed there? A. Twenty-one.

(Deposition of Thomas H. Edgin.)

Q. Would you please read the first one, sir?

A. Automatic filtering unit incorporated in machine.

Q. And what advantage is there to you because the automatic filtering unit is incorporated in the machine?

A. Well, the automatic filtering unit removes all of the loose sealing material that has been stripped out of the wing and takes it out of the recirculating system, thereby preventing the further weakening of the solution; and also it eliminates the hand-work and any manual work of the people who had to previously had to get in the wing to carry it out.

\* \* \* \* \*

Q. Alright, sir, what is the sixth advantage you have listed there?

A. The absence of fumes in the whole hangar to work.

Q. Did you have fumes in the whole hangar when you used the fill and drain method?

A. On numerous occasions it was quite a frequent happening that on fill and drain the desealing material would eat out the sealing material and leak out on the hangar floor causing a mess and it rapidly evaporated and bothered people's eyes.

Q. And this problem was entirely eliminated by the recirculating spray system, was it?

A. For all practical purposes it was. [27]

\* \* \* \* \*

DEFENDANTS' EXHIBIT "A"

(Copy)

OKLAHOMA CITY AIR MATERIEL AREA

Tinker Air Force Base

Oklahoma City, Oklahoma

Cee-Bee Chemical Co., Inc.

655-57 East Gage Avenue

Los Angeles 1, California

Gentlemen:

Copy of evaluation report of the Cee-Bee desealing process is forwarded for your information.

Sincerely,

W. O. MOORE,

Colonel, USAF,

Director, Maint. Engineering,

By TOM EDGIN,

Engr.

1 Incl

Report

(Copy)

EVALUATION REPORT OF THE CEE-BEE  
DESEALING PROCESS

A C-54 type airplane was selected for this demonstration. The fuel tanks were sealed with TC-48 material which averaged  $\frac{1}{8}$ " thickness. The corners and doors were sealed with EC-801 (AAF Spec 14153) which averaged  $\frac{1}{2}$ " thickness. The average time and materials required for desealing this type airplane by the fill and drain process is used for comparative purposes. The time and materials aver-

ages are taken only from airplanes sealed with TC-48 material that have been desealed at this Headquarters.

(Copy)

## FILL & DRAIN METHOD

### Material Needed

Mixture of 70% Dichloride, 30% methylene chloride. .01% Triethylamine and .1% Naccanol @ \$1.67 per gal. (mixed)  
—4000 gal. required per airplane.

Total Material Cost: ..... \$6,680.00

### Cost of Material Lost

1200 gal. @ \$1.67 per gal..... \$2,004.00

Cost: ..... \$2,004.00

### Elapsed Time

14½ Days Total

12½ working days

2 days over weekend

2 shifts per day

### Manhours

32 Manhours for mixing material

32 Manhours for setting up & filling tanks

1400 Manhours for hand work

---

1464 Total Manhours

### Total Cost

1464 Manhours @ \$2.81 per hr..... \$4,113.84

1200 Gallon material @ \$1.67 per gal..... 2,004.00

---

Total Cost: ..... \$6,117.84



## CEE-BEE CHEMICAL CO. PROCESS

## Material Needed

495 Gal. Cee-Bee PR-37 @ \$3.15 per gal.	\$1,559.25
55 Gal. Cee-Bee PR-38 @ \$3.65 per gal...	200.75

---

Total Material Cost:..... \$1,760.00

Cost of current to operate equipment: negligible.

## Cost of Material Lost

275 Gal. Cee-Bee PR-37 @ \$3.15 per gal. \$	866.25
55 Gal. Cee-Bee PR-38 @ \$3.65 per gal...	200.75

---

Cost: ..... \$1,067.00

## Elapsed Time

5 Days Total

2 shifts per day

## Manhours

24 Manhours for setting up equipment

460 Manhours for hand work

---

484 Total Manhours

## Total Cost

484 Manhours @ \$2.81 per hr.....	\$1,360.04
330 Gal. Cee-Bee Stripper.....	1,067.00

---

Total Cost: ..... \$2,427.04

ROTO JET PROCESS

Material Needed

522 Gal. Turco 2822 Thin @ \$2.97 per gal.	\$1,550.34
96 Gal. Gasoline @ \$.25 per gal.....	24.00
<hr/>	
Total Material Cost:.....	\$1,574.34

Cost of Material Lost

192.5 gal. Turco 2822 Thin @ \$2.97 per gal. ....	\$ 569.80
96 gal. gasoline @ \$.25 per gal.....	24.00
<hr/>	
Cost: .....	\$ 593.80

Elapsed Time

- 9 Days Total
  - 7 working days
  - 2 days over weekend
  - 2 shifts per day

Manhours

- 40 Manhours for setting up equipment
  - 763 Manhours for hand work
- 
- 803 Total Manhours

Total Cost

803 Manhours @ \$2.81 per hr.....	\$2,256.43
96 Gal. Gasoline @ \$.25 per gal. ....	24.00
192.5 Gal. Turco 2822 Thin @ \$2.97 per gal. ....	569.80
<hr/>	
Total Cost: .....	\$2,877.23

(Copy)

Other Important Advantages of the Cee-Bee  
Chemical Co. Process

1. Automatic filtering unit incorporated in machine.
2. Individual electric driven pumps for each operation.
3. All desealing hoses metal covered.
4. Spray nozzles concentrated at corners and fittings.
5. Positive check on all spray nozzles during operation.
6. Absence of fumes in whole hangar to work.
7. Toxicity and hazards are minimized.
8. No need for transferring large quantities of material.
9. No need for large storage and inventory.
10. Workmen do not come in direct contact with stripper.
11. Desealing machine is portable and self contained.
12. Actual stripping time is reduced.
13. The need for spray or brush on of stripper is minimized.
14. No need for fill and drain.
15. Removal of loose sealant during recirculating permits following:
  - a. Longer tank life of solution.
  - b. Allows fresh stripper to work on unremoved sealant.
  - c. Minimizes removal of loose sealant by 90%.

16. With present facilities, twice as many tanks can be stripped with one unit.

17. Permits inspection of stripper process during operation.

18. Less damage to tank due to hand picking.

19. Small quantity of material required for operation.

20. Two outer panels can be run simultaneously or main and auxiliary.

21. High pressure rinse can be done simultaneously with desealing operation.

[Endorsed]: Filed Oct. 17, 1955.

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[Title of District Court and Cause.]

## DEPOSITION OF CHARLES R. URSELL

Brownsville, Texas

January 29, 1957

\* \* \* \* \*

### CHARLES R. URSELL

a witness named in the annexed notice, being of lawful age, and being first duly sworn in the above cause, testified on his oath as follows:

#### Direct Examination

Q. (By Mr. Welsh): Will you please state your full name, sir?      A. Charles R. Ursell.

Q. Where do you reside, Mr. Ursell?

A. 1718 Boca Chica Boulevard, Brownsville, Texas.

Q. We are now in Brownsville, Texas taking your deposition, is that correct?

A. That is correct.

(Deposition of Charles R. Ursell.)

Q. Mr. Ursell, by whom are you employed?

A. Pan American World Airways.

Q. In what capacity are you employed by them?

A. Maintenance Engineer.

Q. How long have you been employed by that company?

A. Fourteen years.

Q. And in what particular division of the Pan American Airways are you employed?

A. Maintenance.

Q. Is there a maintenance plant or maintenance facilities here in Brownsville?

A. Yes. [4]\*

\* \* \* \* \*

Q. Have you ever written anything concerning airplane wings or fuel tanks?

A. Yes, in the late 1940's, I don't remember the year exactly, approximately 1945. Mr. Zerelli, Mr. Lindberg and myself, all with Pan American, wrote an S.A.E. paper on all forms of fuel carrying facilities, such as tanks, bladder and integral tanks. [6]

\* \* \* \* \*

Q. Do you hold any position or do you have any quasi official position with the United States Civil Aeronautical Authority?

A. Other than a pilot's license I am also designated Engineering Representative for the Civil Aeronautics Administration qualified in structures, systems and equipment. [7]

\* \* \* \* \*

Q. Now, would integral fuel tanks, their con-

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\* Page numbers appearing at top of page of Original Deposition.



(Deposition of Charles R. Ursell.)

struction and their sealing and so forth, come within your authority as representative of the C.A.A.?

A. Yes. Integral fuel tanks has always been considered a part of structure. [8]

\* \* \* \* \*

A. Sealant was removed by what is commonly referred to as the hand method of scraping the sealant out and using solvent to clean it thereafter.

Q. Was that method unsatisfactory or satisfactory?

A. We consider it unsatisfactory. [11]

\* \* \* \* \*

A. In 1946, I believe the date was, we tried to desal a Constellation oil barrel by the fill and drain method, simply by filling it up with stripping compound and pumping it out and filling it up again and pumping it out. This didn't prove very successful. [12] \* \* \* \* \*

Q. All right, did you at some time hear of a method which the Cee-Bee Chemical Company had for recirculating chemicals in the integral fuel tanks? A. Yes.

Q. When was that? A. About 1946.

\* \* \* \* \*

Q. I hand you this document, Mr. Ursell, which shows figures "1" and "2" of the patent in suit and ask you if the method indicated on that document is the method which the Cee-Bee [15] Chemical Company at some time showed to you?

A. Yes. \* \* \* \* \*

(Deposition of Charles R. Ursell.)

(Said instrument marked for identification as Defendant's Exhibit "A".) [16]

\* \* \* \* \*

A. When I was first told about it, and after four years of digging for answers to the desealing problem, I received it as skeptical as a person can be, because of so many other ideas that were offered along the same line. After visiting the L.A.S.I. desealing operation and viewing the end results I was impressed to the point that I advised our management in Miami that we should also make a trial utilization of this equipment.

\* \* \* \* \*

A. I believe it took me about two years to convince my management and I think the time was 1948 or '49 when they desealed a Lockheed Constellation in Miami, which I believe is the first Lockheed Constellation to ever be completely [17] desealed and resealed to that date.

\* \* \* \* \*

Q. What was the results of that procedure?

A. When the aircraft was ready for resealing after they had completed the entire desealing operation I was amazed to find that we could disassemble some of the structural joints without finding but a bare minimum of desealing compound in the faying surface.

\* \* \* \* \*

Q. All right. How did you consider the entire job to have worked out?

A. Very satisfactory. In fact, that was the only

(Deposition of Charles R. Ursell.)

Lockheed Constellation we desealed and resealed in our entire fleet because we were preparing to retire the fleet or sell it and to date that airplane has had the fewest fuel leaks in integral [18] fuel tank problems on any of the Constellations we have been flying.

\* \* \* \* \*

Q. As a result of your satisfaction with this method in using it on your own ground, what, if any, changes did you make in your procedures for desealing your aircraft?

A. All aircraft thereafter operated out of the Miami base that were desealed, were desealed by the Cee-Bee method.

\* \* \* \* \*

A. In the three years that I have been working back in Brownsville we have solely used the Cee-Bee desealing method and that has been on a number of aircraft.

Q. Is that method the same method which is shown schematically in Defendant's Exhibit "A" for identification?      A. Yes.

Q. Now, does the Cee-Bee recirculating method have certain advantages which were not present in the other methods which you had used? You may answer that "yes" or "no".      A. Yes.

Q. Can you please state what those advantages are? [19]

A. The first advantage is the use of a minimum amount of manpower; second advantage——

\* \* \* \* \*

(Deposition of Charles R. Ursell.)

A. The second advantage is the shorter elapsed time to accomplish the end results and this is accomplished by the fact there are only so many holes in the wing and therefore you can only put so many men in the holes to do the job. And therefore with the total man-hours it takes a certain elapsed amount of time to do that job whereas the machine can operate in all holes at once and eliminate all but one man to watch the machine. Therefore, saving considerable manpower and elapsed time by doing the job all at once. [20]

\* \* \* \* \*

A. The end results of the job by using the Cee-Bee Method is a much cleaner tank. That naturally means better sealing because today's sealants are better than they used to be. It requires a chemically clean surface and by doing the job by hand it is much more difficult to get that clean a surface than it is by the spray method.

Q. All right. Can you think of any other advantages, if there is any?

A. The airplane down-time is shortened and the overall cost is shortened. [21]

\* \* \* \* \*

Q. Is there any advantage in so far as protection to the plane's surface itself?

A. Yes. When you use the spray method or Cee-Bee Method you don't have to go in and scrape all this sealant out and therefore you can eliminate the possible damage to the structure. You can eliminate

(Deposition of Charles R. Ursell.)

the personnel hazard caused by handling the powerful stripping compound. [22]

\* \* \* \* \*

Q. Before the Cee-Bee Method was brought to your attention did you at any time consider using a similar method to that used in cleaning railroad cars and ship's hulls, using such a method in your desealing operations? A. No.

Q. Since you have experience in this particular field of desealing, as you have indicated, can you tell me whether or not in your opinion one who is versed in the art of desealing aircraft integral fuel tanks would ordinarily think of applying to the desealing operation a method similar to that which is used in railroad tanks and ship's hulls?

A. No, I would never think to apply something like that to the aircraft business, because first the different types of metal. The aircraft is basically aluminum and light weight structure, very thin, whereas ships and railroad cars and so forth are basically steel and very heavy structure. And the loss of any of the thickness of metal wouldn't have very much [25] effect on a ship or tank whereas an airplane, even 1/1000 of an inch is important to us. I might add that in the engineering field that the decimal point that the bridge or ship engineers throw away, that is all we deal in in the aircraft business, the decimal point to the right. You have got a different size of unit, a ship or tank is a mammoth thing. Some tanks are fairly small, but at least they are normally big enough for a man to get



(Deposition of Charles R. Ursell.)

into, whereas an aircraft tank until the B-36 came along was rather small hole and normally a man couldn't even get into it. The second thing is, they normally wouldn't cut a hole big enough in one of those things for a man to get through, because of the basic structure of the airplane which you have to cut through.

\* \* \* \* \*

Q. Now, before you used the Cee-Bee recirculating Method how did you take the sealant compound out of the aircraft stringers?

A. Well, at first they were so difficult to clean out that [26] we just plugged them up and forgot about them, but then we found out to have a tank free from leaks you have to get under there and clean that out and put it back together again, you have to lift the stringer out and clean it out and put it back.

\* \* \* \* \*

Q. Now, you say it was necessary to actually physically remove this stringer in order to effectively clean it, is that right?      A. Yes.

Q. Now, did the Cee-Bee recirculating method make any difference in the process you had to follow in order to effectively clean the stringers?

A. Yes. With that pressure spray method they offered a process of inserting a tube in that section and forcing the removed sealant out by pressure method and it would work all the way through the stringer if you would let it run full time that the tank was being desealed in the other areas. This

(Deposition of Charles R. Ursell.)

was [27] a time saving operation in that after the remainder of the tank was desealed you didn't have to go in and clean out the stringers, they were already cleaned out at the same time. [28]

\* \* \* \* \*

Cross Examination \* \* \* \* \*

Q. (By Mr. Huntley): You mentioned that in the old process you had to remove the stringers?

A. If we wanted to clean that section.

Q. The Cee-Bee Company has offered a method of cleaning these stringers in place? A. Right.

Q. Is that method shown on Exhibit "A"?

A. No, there is no reference on this Exhibit "A" at all dealing with stringers. [45]

\* \* \* \* \*

[Endorsed]: Filed Feb. 12, 1957.

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[Title of District Court and Cause.]

DEPOSITION OF SYDNEY G. THORNBURY

Los Angeles, California

March 7, 1957

\* \* \* \* \*

SYDNEY G. THORNBURY

a witness called by the defendant and being first duly sworn, testified as follows:

\* \* \* \* \*

Direct Examination

Q. (By Mr. Stratton): Will you state your name and business address, please?

A. My name is Sydney G. Thornbury. "Syd-

(Deposition of Sydney G. Thornbury.)

ney" is spelled with a "y". My business address is Turco Products, Inc., 6135 South Central Avenue, Los Angeles.

Q. What is your occupation?

A. I am the president of Turco Products.

Q. How long have you been connected with this company?

A. Since 1927 or about 30 years.

Q. How long have you been president of this company?

A. Since 1938. [2]\*

\* \* \* \* \*

Q. What college did you attend?

A. I attended the University of Oregon and the University of California at Los Angeles.

Q. How many years of academic training did you have in those two colleges?

A. Five.

Q. And did that academic training include any academic work in chemistry?

A. Yes; it did. [3]

\* \* \* \* \*

Q. Are you a member of any chemical organization?

A. Yes; I am a member of the American Chemical Society.

Q. How long have you been a member of that Society?

A. For something over 20 years.

\* \* \* \* \*

Q. Are you familiar with Cee-Bee Patent No.

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\* Page numbers appearing at top of page of Original Deposition.

(Deposition of Sydney G. Thornbury.)

2,653,116, which is the patent involved in the present suit?      A. Yes.

Q. And are you familiar with the process of desealing integral aircraft wing fuel tanks covered in that patent?      A. Yes; quite generally.

Q. When did you first hear of it?

A. I am not sure that I understand the question. When did I first hear of the patent?

Q. No; the process.

A. Of the process of removing sealant from integral fuel tanks?

Q. Yes.

A. About 1943 or '4, I believe. At least it was at [4] that point when it became a matter of some reasonable interest.

Q. Do you mean when the need for such arose?

A. Yes; that is right.

Q. Does not the patented process that I referred to include the removal of sealant by spraying solvent or stripper against the sealant in the aircraft wing tank?      A. Yes; it does.

Q. What is the nature of the solvent or stripper that is used to remove the sealant from aircraft wing fuel tanks?

A. Typically, it is a highly volatile solvent. Those commonly in use are based upon chlorinated hydrocarbons, customarily methylene chloride, which are activated in various ways to cause them to attack the rubbery sealant compound either to tear it loose from the sides of the walls or by bringing it into solution. \* \* \* \* \* [5]

(Deposition of Sydney G. Thornbury.)

Q. And what is the nature of the sealant after the solvent or stripper is applied to it?

A. Typically, it goes through various stages of gooiness. We have a term which we apply to this. We call it gooification. The solvent begins by causing the rubber to swell. In some cases the swelling may be sufficient to loosen the adhesive bond to the sides of the tank, but, more typically, it becomes gooey on the surface and gradually swells through the entire polymer, becoming increasingly gooey and eventually, if the contact time is sufficient it may pass into solution. [6]

Q. Would you say that the sealant has the same condition whether it is soaked in the solvent or whether the solvent is sprayed on the sealant?

A. Assuming that the exposure is equivalent, that is, equivalent in effect, not necessarily equivalent in time, the result should be the same.

Q. You were familiar with these facts about the nature of the solvent and sealant at the time that you first heard of the Cee-Bee spray process, weren't you?      A. Yes; I was.

Q. Were you at that time of the opinion that the Cee-Bee spray process would or would not be operative?

A. I did not believe the process would be operative.

\* \* \* \* \*

Q. Why did you feel that the Cee-Bee spray process would not be operative?



(Deposition of Sydney G. Thornbury.)

A. To begin with, there is an inherent difficulty in the cleaning of any enclosed vessel of complicated shape by a spray process and that problem is the problem of actually getting complete coverage of the entire inner surface, particularly in an aircraft wing tank where you have baffles and stringers, reinforcing members, rivets, and so on, behind which or under which the sealant is. The problem of actually getting contact of the desecant with the sealing [7] compound appeared to me to be probably unsolvable, and there were other difficulties which appeared to me to be quite real.

\* \* \* \* \*

It seemed to me reasonably certain that the solvent saturated by this gooey material could not be successfully circulated through sprays; that the sprays would plug up; that the entire circulating system itself would quickly be fouled up to the point where the cleaning time necessary to keep it operating would make it economically impractical.

\* \* \* \* \*

Q. (By Mr. Stratton): Does Turco Products, Inc. manufacture or have manufactured for it and either use or sell machines for spraying solvent or stripper on a sealant in an integral aircraft fuel tank for removing sealant from loosened solvent and for respraying the solvent on remaining sealant in a closed circuit?      A. Yes. [9]

Q. And the Cee-Bee Chemical Company also has machines of this character?      A. Yes; they do.

(Deposition of Sydney G. Thornbury.)

Q. And you have seen the latter in operation?

A. Yes.

Q. Did Turco Products, Inc. first build such a machine before or after you first saw Cee-Bee's such machines operate?      A. Afterwards.

Q. Is Turco Products, Inc. now a licensee under the Cee-Bee patent in suit?      A. Yes; it is. [10]

\* \* \* \* \*

Q. What are stringers in aircraft?

A. Stringers are reinforcing members. Shall I describe them?

Q. Where are they found in aircraft?

A. They are located in the fuel cell structure.

Q. Do you mean in the wings of aircraft?

A. That is right, inside of the wings.

Q. And is it a fact that they run longitudinally with the wings and are for strengthening purposes?

A. That is correct.

Q. And are you familiar with the fill, soak and drain method of removing sealant from aircraft wing tanks?      A. Yes; I am.

Q. And are you familiar with trying to remove sealant from stringers by the fill, soak and drain method?      A. Yes.

Q. And what is the situation there?

A. Well, actually, by straight fill and drain, this job usually cannot be done. The stringer is thoroughly filled with the sealing compound in many of the ships and, while the solvent applied by fill and drain will attack the [11] sealant at the ends

(Deposition of Sydney G. Thornbury.)

of the stringers, it has some exposure to it. I have never seen an instance, that I recall, where the sealant in the stringer was successfully removed merely by that method.

\* \* \* \* \*

Q. Could you tell me whether the fill, soak and drain method was ever generally used in the industry for desealing aircraft wing fuel tanks?

A. Yes; I would say it was generally used. [12]

\* \* \* \* \*

Q. Can you tell what the effect is on the spray method of cleaning out the sealant from the stringers?

A. If the spray method is so arranged that there is definite contact of the vapors of the solvent with the sealant in the stringers, it can be removed.

Q. Are the stringers or are they not now required to have their sealant removed when there is a desealing operation on the fuel tank of an aircraft?

A. I understand generally it is required.

Q. Before Turco Products, Inc. built its first machine for desealing purposes, do you know whether any objections were made as to whether spraying the solvent or stripper would be dangerous?

\* \* \* \* \*

The Witness: Yes.

Q. (By Mr. Stratton): And can you tell me what the nature of those objections was?

\* \* \* \* \*

(Deposition of Sydney G. Thornbury.)

A. The objections raised were those that I mentioned earlier, the possibility of introducing toxic fumes into the air, the probability of high cost operation, the possibility of fire hazard and the practical difficulties of actually [13] getting contact of the solvent on all of the sealants, and there were other objections raised. As I think I pointed out, these tanks are of baffled construction, which means that they are divided into compartments with only small openings typically between the baffled compartments. This would appear to mean that some sort of plumbing job would be necessary in order to get spray heads into each separate compartment and so on.

\* \* \* \* \*

Q. (By Mr. Stratton): Were you one of the persons who made these objections?

A. Yes; I was.

Q. Are these baffles sometimes called bulkheads?

A. Yes.

Q. Can you tell me what the effect is of spray fumes in an aircraft integral tank during the de-sealing operation when a desealant is sprayed in the tank?

A. The fumes themselves have an effect on the sealant analogous to the effect of the solvent in liquid form. The rubber absorbs the fumes and starts going through the swelling, softening the solution, stages which I think I described [14] earlier.

(Deposition of Sydney G. Thornbury.)

Q. Can you state whether these fumes reach any parts of the sealant that are not reached by impingement of the sprays?

A. Yes. This was an unexpected dividend of the spray process. We found, contrary to what we had supposed, it was possible to reach these areas effectively by the fumes even where the solvent in liquid form would not go.

Q. You say they were unexpected. Do you mean you did not anticipate these until it was actually tried?

A. That is true.

Q. Did Turco Products, Inc. have a license under Land Patent No. 1,666,015?

A. Yes; we did.

Q. And at what period, approximately?

A. As I recall it, we took out that license in 1930. I am not positive about this date, but that is my recollection, and we were licensed under the patent, I believe until it expired, which would have been in 1945 or 1947—1945. [15]

\* \* \* \* \*

Q. Would you state whether or not the spray method about which you have testified has largely displaced the fill, soak and drain method in the industry of cleaning sealant from integral aircraft fuel tanks?

A. It has largely displaced it in many segments of the aircraft industry, but the other methods are still used to some extent.

Q. Which method is used more than any other?



(Deposition of Sydney G. Thornbury.)

A. The spray method is the most commonly used.

Q. Was there or was there not a long-felt need in the industry for a method to remove sealant satisfactorily, economically and with dispatch, when the spray method began to be adopted by the de-sealing industry?

A. Yes, sir. [16]

\* \* \* \* \*

Cross Examination \* \* \* \* \*

Q. (By Mr. Huntley): On the question of cleaning stringers, you stated that the spray process will clean the stringers out if the process was so arranged that there is a definite contact of the fumes with the sealant in the stringer. In the practice of this spray process, is it left solely to the contact of fumes with the sealant in the stringer or are there auxiliary methods used to clean out the stringers?

A. Very frequently auxiliary methods are used.

Q. And what are those?

A. As I have seen it done, an auxiliary line from the spray machine is directed at the stringer to get as much liquid contact as can be obtained in that way. [18]

Q. This is a separate spray?

A. That is right.

Q. Separate and distinct from the sprays that are used to spray the general interior of the tank, is that right?

A. It would be a separate nozzle. \* \* \* \* \* [19]

Q. (By Mr. Huntley): You testified, I believe,

(Deposition of Sydney G. Thornbury.)

that in the fill, soak and drain method the stringers were not cleaned out but that in the spray method the stringers would be cleaned out if the fumes were to reach the material on the inside of the stringer, is that correct?

A. Yes; at least in part.

Q. And you also testified that the action of the fumes on the sealant is substantially the same as the action of the same chemical in a liquid phase has on the sealant? A. Yes.

Q. Would not the liquid in the fill, soak and drain process reach substantially every point that is reached by the fumes in the spray process?

A. Well, it is true that in both cases it was necessary to make adaptations of the process.

Q. In other words, for cleaning out the stringers, something extra and special has to be done to clean out the stringers?

A. It is advisable; yes. But, in the case of the fill and drain, this means the adoption of what may be an element of the spray method, that is, you may provide an auxiliary spray system with the fill and drain method in order to accomplish this thoroughly.

Q. And you may also provide such an auxiliary spray with the spray system, is that right?

A. Yes. [20]

Q. Did I understand your testimony correctly to be that the need for an economical and effective method of desealing first became apparent when

(Deposition of Sydney G. Thornbury.)

the need for desealing C-54s and DC-4s became apparent?

A. Yes; I think that is generally true. This was the first time that there were substantial numbers of these planes in constant daily use.

Q. I think you testified on one occasion that this may have been around 1943 or 1944 and then a few moments ago you said this was probably 1945 or 1946. Can you fix the date any more closely than the span of three or four years?

A. As I recall it, we first became actively interested in the problem in 1944 and actually desealed our first ship, our first C-54, in 1945. This is as I recall it and I think the dates are right.

Q. Prior to that time, at least as far as aircraft wing tanks were concerned, there was no actual need for such a desealing process, isn't that true?

A. Prior to that time some desealing was done, but it was minor in amount. So that the pressure for a more effective or less expensive method did not exist or at least it was not directed to our attention.

Q. Is it not true that, prior to 1945-1946, this same process was used in the cleaning of tanks other than airplane wing tanks, as, for example, railway tank cars? [21]

A. I think that would require me to define what the "same process" is. As I have indicated in an affidavit, the spray method of cleaning tank cars, marine tanks, storage vats, and so on, was in use for a very long time.

(Deposition of Sydney G. Thornbury.)

Q. And by a very long time, do you mean prior to 1945 or 1946? A. Yes.

\* \* \* \* \*

Redirect Examination \* \* \* \* \*

Q. (By Mr. Stratton): Can you tell me what method you used to deseal the [22] first aircraft integral fuel tank?

A. This was done by the method which we called the spray and scrape method. In other words, a man would actually stick his head up into the integral tank, the bottom section having been removed, and would apply the desealant by means of a pressure pot, something of the type used for spraying paint. This would then be allowed to stay in contact with the desealant until it was partially softened. It might be then resprayed one or several times and then finally the sealant would be removed by hand-scraping and then would follow various hand-cleaning methods, hand-picking, the use of a solvent applied by brush or a rag to clean up the residual traces, followed then perhaps by chromic acid rinse to passivate the surface. This is the method in which the so-called "Men From Mars" costumes were used. This involved protective clothing and the use of helmets to supply air for breathing and so on.

Q. Can you tell what objections there were to that method, why it wasn't continued instead of the patented spray method?

A. The basic objection was the question of the time required and the high labor charges.

(Deposition of Sydney G. Thornbury.)

Q. Do you mean it was prohibitively expensive for labor?           A. Yes; I would say so. [23]

\* \* \* \* \*

Q. And what were you referring to as having happened in 1944? That you first became acquainted with this method or what?

A. It was in 1944 we began to take a substantial interest in the possibility of a market for chemicals to be used for this purpose. We conferred with the representatives of the aircraft plants and with the military and we started designing our chemicals to be used for this purpose.

Q. In what year?           A. In 1944. [24]

\* \* \* \* \*

Q. Then you would be spraying the sealant in the stringer?

A. Yes. However, where the stringer is absolutely sealed, there is a good chance of the vapors getting in where it would be difficult for the liquid to follow, if I make myself clear. [26]

\* \* \* \* \*

Q. Is there any complicated shape as to the tank car shown in that drawing?

\* \* \* \* \*

A. The only complication shown is the bell-shaped top of the tank or I mean the point of entry.

Q. That small dome in the center of the top?

\* \* \* \* \*

A. As shown in the drawing, it is a cylindrical-shaped tank, without any apparent complications.



(Deposition of Sydney G. Thornbury.)

Q. Does that cylindrical-shaped tank have any baffles or stringers in it? A. Not as shown.

\* \* \* \* \*

Q. And is there any material in that that would have stages of gooification that you have referred to?

A. I don't recall any difficulties of that kind.

Q. And there is nothing in that tank that would foul up the sprays shown therein?

A. Well, nothing is shown in the drawing. I mean there is nothing shown as to the character of the soil that might be in the tank.

Q. What is the usual material, that you have referred to as soil, that would be removed from a tank car?

A. It varies considerably. These tanks, of course, carry many things; typically, vegetable oils, for example, lard, petroleum products, gasoline and light distillates and crude oil.

Q. Would you include molasses and milk in the contents of tank cars? A. Yes.

Q. Are any of these materials that you or I have mentioned of a gooey nature?

A. Well, you run into questions of definition there.

Q. Molasses might be gooey, but I mean, when it is mixed with water, is the resultant mixture or any part of it gooey?

A. It is not gooey in the sense that a softened rubber is gooey.

Q. Is there any mechanical problem in a tank

(Deposition of Sydney G. Thornbury.)

car in reaching the entire area within the tank?

A. Yes, depending on the construction of the tank.

Q. In the tank that is shown here in this drawing, [28] Exhibit B, is there any problem?

A. No.

Q. What is the nature of the material that is used to remove the different oily or petroleum products, that you have mentioned, in removing them from a tank car?

A. Most commonly it is an alkaline detergent dissolved in a heated-water solution.

Q. Is it a material, when so mixed, say similar to the result that a housewife obtains in a washing machine where she mixes a detergent with the water in it?

A. Yes; this would be comparable except that stronger chemicals are used than the housewife would commonly employ. [29]

\* \* \* \* \*

Recross Examination \* \* \* \* \*

Q. (By Mr. Huntley): You are reasonably familiar, then, with the construction of railway tank cars? A. Yes.

Q. It is not uncommon, is it, for such tank cars to have baffles and antislosh plates and such things?

A. That is true. They are built that way.

Q. Also, it is not uncommon to transport such materials as asphalt in these cars, is it? [30]

A. That is true.

Q. And do they not also carry some of the syn-

(Deposition of Sydney G. Thornbury.)

thetic plastic materials unpolymerized?

A. Yes; I believe that is true.

Q. These are fairly heavy, sticky, gummy, gooey, liquids, are they not?      A. Undoubtedly.

\* \* \* \* \*

Q. It is true, is it not, that in the cleaning of tank cars solvents are used as well as water solutions or detergents?      A. Yes; on occasions.

Q. To go back to airplane wings, you testified on redirect examination concerning difficulties of getting contact between the liquid and the material in the stringer in the upper part of the tank?

A. Yes. \* \* \* \* \* [31]

Q. Are there such stringers or reinforcing members in the lower part of the tank?

A. Yes; I believe so.

Q. These would be completely submerged in the fill and drain process, wouldn't they?

A. Yes.

Q. Now, considering the upper stringers, if I understand the problem correctly, you had what I will call a dead air space at the top of the tank?

A. That is correct.

Q. So that the liquid level did not reach up to the stringer? Is that the problem?

A. That is one of the problems; yes.

Q. Isn't this dead air space saturated with the vapor of the solvent with which the tank is filled?

A. Certainly, it would carry some of the vapor, but whether it would be saturated or not I don't really know. [32]

\* \* \* \* \*

(Deposition of Sydney G. Thornbury.)

Q. This physical process that goes on in a dead space above a liquid consists in molecules of the chemical solvent escaping from the liquid body and entering the space above and other molecules returning back to the liquid and this is an equilibrium condition, isn't it? When equilibrium conditions are established, the molecules re-enter the liquid at the same rate the other molecules leave the liquid, isn't that true?

A. I think this is the accepted theory.

Q. So you have what is, in effect, a constant generation of vapor and a constant condensation back into the body of the liquid, is that true?

A. Yes.

Q. And it is in this space that the stringer we are talking about is located, is it not? [33]

A. That is true.

Q. So there would certainly be some opportunity, a substantial opportunity, for this vapor to come in contact with the sealant?

A. There would certainly be some opportunity for it to happen. [34]

\* \* \* \* \*

Redirect Examination \* \* \* \* \*

Q. (By Mr. Stratton): Let me restate it. Counsel for the plaintiff is apparently trying to show that there are fumes no matter which method is used, the fill, soak and drain method or the spray method, and I am asking whether there is any difference in the efficiency of those fumes when you use the fill, soak and drain method and the fumes

(Deposition of Sydney G. Thornbury.)

that are produced in the tank by the use of the spray method.

A. That is not quite the same thing, if I understand [35] your question. I said earlier that the typical solvent used in these desealants is methylene chloride and this solvent boils not many degrees above room temperature; and I believe that what occurs here is that, by the friction of spraying the solution, the solvent in part may actually be heated above its boiling point. So that what contacts the sealant in the spray method is something approaching pure solvent in the vapor phase rather than the theoretical mixture of air and solvent which might lay above a static body of the desealant liquid at a temperature below the boiling point of that liquid. [36]

\* \* \* \* \*

Recross Examination \* \* \* \* \*

Q. (By Mr. Huntley): Then, I will ask it again. Isn't it true that, in order to do a completely adequate and satisfactory job of cleaning out stringers, resort must be had to some means other than the mere contact of the vapor with the material in the stringer?

A. Yes; I would say, generally speaking, that is probably true.

Q. And these other expedients are the use of an auxiliary spray, for example, as you previously testified? Is [37] that not so? A. Yes. [38]

\* \* \* \* \*

[Endorsed]: Filed March 27, 1957.



[Title of District Court and Cause.]

## TRANSCRIPT OF PROCEEDINGS

Los Angeles, California

Monday, February 11, 1957

Honorable William C. Mathes, Judge Presiding.

Appearances: For the Plaintiff: Fulwider, Mattingly & Huntley, By—Walter P. Huntley, Esq., 5225 Wilshire Boulevard, Los Angeles, California. For the Defendant: C. G. Stratton, Esq. and Louis Welsh, Esq., 210 West Seventh Street, Los Angeles, California. [1]\*

Monday, February 11, 1957; 10:10 A.M.

The Clerk: Case No. 17,387, Delco Chemicals, Inc. vs. Cee-Bee Chemical Co., Inc.

The Court: Is there anything to be said on these motions to produce other than what has been said in the memorandums, gentlemen?

Mr. Stratton: There is only one other thing, your Honor, in this motion to compel the production of documents that was not stated here.

The record shows that some over \$11,000 was paid by the plaintiff to its employees for salaries in supervising and directing the carrying out of the accused process.

The Court: The defendant's motion deals with the question of damages, doesn't it?

Mr. Stratton: Yes, your Honor.

The Court: We are a long ways from that.

Mr. Stratton: This is a jury case. We will need

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\* Page numbers appearing at top of page of Reporter's Transcript of Record.

it for the trial, your Honor. That is, at the time of the trial next week we will need to present to the jury how much damage the defendant has suffered.

The Court: Anything further?

Mr. Stratton: No, your Honor.

The Court: The plaintiff's motion for compelling production will be granted. [2]

Mr. Welsh: I wanted to oppose this motion.

The Court: Which motion?

Mr. Welsh: Plaintiff's motion for production of documents.

Mr. Stratton: We are the defendants.

Mr. Huntley: There are two motions.

The Court: Plaintiff's motion, and there is defendant's motion, as I read the record. I am granting the plaintiff's motion. I haven't ruled on the defendant's motion.

Mr. Stratton: It was the defendant's motion I was speaking of, your Honor.

The Court: I understand.

I will deny defendant's motion, without prejudice to a renewal of it if this case goes to trial by jury.

In going over this voluminous file, gentlemen, I am wondering if the matter couldn't possibly be disposed of if the plaintiff should make a motion for a summary judgment on the counterclaim. And I will entertain a motion for a summary judgment on the counterclaim if the defendant is advised to grant it. I am not disposed to spend a week hearing this case before a jury, gentlemen, in the present posture of it. I never had an opportunity to go over the file before. I received this case upon a transfer.

I don't know what the outcome of the motion would be, but I would like to explore the possibility of disposing of [3] it on a motion for summary judgment.

Mr. Welsh: May I speak to that, your Honor?

The Court: Yes.

Mr. Welsh: I question the advisability of a motion for summary judgment in this case because there is a very definite issue of fact which will be presented to the court.

The Court: What issue?

Mr. Welsh: The issues, of course, dealing with question of patentability. I don't think there is any question of infringement. The infringement is clear.

The Court: Is there anything complicated about this patent at all in process? Anything at all that could possibly be opened to require the testimony of experts to explain the process?

Mr. Welsh: Oh, I don't think we need experts.

The Court: Or is the prior art so complicated that the court can't understand it?

Mr. Welsh: I think the court could understand this case or any other case. That isn't the point.

The Court: That is very flattering, but we'll just talk about this case.

Mr. Welsh: My point is that I don't feel whether the court is capable of understanding it or not has anything to do with whether or not a motion for summary judgment should be granted. [4]

The Court: I am familiar with all that has been said, I think, in the Court of Appeals on this subject.

Then there is the question of prior public use. Is that affidavit of prior public use denied?

Mr. Welsh: There is no prior public use that I am aware of.

The Court: Isn't there an affidavit of prior public use?

Mr. Stratton: Not in this case. The affidavit was that they had used it before this case was filed, a few weeks before, so as to grant jurisdiction to this court. Otherwise, their case would have been thrown out of the court on the ground they had not made any use——

The Court: I misread the date in the affidavit.

Mr. Welsh: This court, of course, is thoroughly familiar with the—I forget the name of the case. Perhaps Mr. Stratton remembers it. The High Court case.

The Court: If I can't grant it on the issue of validity, perhaps I can grant it on the issue of infringement, which is quite a different situation.

Mr. Welsh: Well, I doubt very much——

The Court: In any event, I will invite a motion, and if the plaintiff doesn't wish to file it, then we will try this case some other time. But I don't intend to spend next week trying this case to a jury. I have never yet tried a [5] patent case to the jury and I don't intend to until I have to.

Mr. Welsh: Very well.

The Court: If the defendant doesn't wish to entertain the possibility of filing a motion for summary judgment, why, then that's another matter.

Mr. Welsh: You are speaking of the plaintiff.

The Court: Yes, on the counterclaim.

Mr. Welsh: Very well.

The Court: And that's another one of these anomalies. These things come in backwards. It's hard enough for the court to keep it straight. It's a patent infringement action backwards; that's what it is. And then you expect to present this to the jury?

Mr. Welsh: We were going to suggest in that connection this morning that we be permitted to proceed first as though we were plaintiff, if this case were tried.

We have no desire to present it in a way that is confusing, and we had planned to suggest that. I don't think we have asked for anything we are not entitled by the Constitution and laws of this nation.

The Court: You are entitled to a trial by jury.

Mr. Welsh: That is all we are asking for.

The Court: Yes.

Mr. Huntley: We will prepare a file and motion for summary [6] judgment as soon as possible.

The Court: Very well.

Mr. Huntley: Shall we attempt to set it for hearing on the date now set for trial, or at a later date?

The Court: Set it for hearing any Monday. I suggest you set it for hearing March 4th.

Mr. Huntley: That will be agreeable.

Mr. Stratton: Then they will, I take it, file it in due time and give us an opportunity of suggesting dates, thinking of the date.



The Court: Is March 4th too early?

Mr. Stratton: It depends on when we get the motion, your Honor.

The Court: It should be noticed in time under the rule.

Mr. Huntley: We should be able to file it within the end of this week. That will give you the 10 days.

Mr. Stratton: That will be satisfactory.

The Court: Very well. The pretrial hearing will be ordered off calendar, pending the hearing and determination on the motion for summary judgment. The trial will be ordered off calendar. And I have already ruled on the motion for production.

[Endorsed]: Filed Dec. 31, 1957.

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[Endorsed]: No. 15893. United States Court of Appeals for the Ninth Circuit. Cee-Bee Chemical Co., Inc., a corporation, Appellant, vs. Delco Chemicals, Inc., a corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: February 14, 1958.

Docketed: February 19, 1958.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for  
The Ninth Circuit.

In the United States Court of Appeals  
for the Ninth Circuit

No. 15893

CEE-BEE CHEMICAL CO., INC., a corporation,  
Appellant,

vs.

DELCO CHEMICALS, INC., a corporation,  
Appellee.

ADOPTION BY APPELLANT OF STATE-  
MENT OF POINTS ON APPEAL AND  
DESIGNATION OF RECORD ON APPEAL

Comes now the above-named appellant, by its counsel, and hereby adopts the Statement of Points on Appeal, and the Designation by Appellant of Contents of Record on Appeal, appearing in the typed record on appeal filed in the above case by the Clerk of the District Court of the United States, Southern District of California, Central Division.

Dated at Los Angeles, California, this 26th day of February, 1958.

C. G. STRATTON,  
LOUIS M. WELSH,  
/s/ By C. G. STRATTON,  
Attorneys for Appellant.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed February 28, 1958. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

ADOPTION AND DESIGNATION BY APPEL-  
LEE OF ADDITIONAL PARTS OF THE  
RECORD TO BE PRINTED

Comes now the above-named Appellee, by its counsel, and adopts the counterdesignation by Appellee, Delco Chemicals, Inc., of additional contents of Record on Appeal as its designation of the additional part of the record which it thinks material and which shall be printed.

Dated at Los Angeles, California, this 3d day of March, 1958.

FULWIDER, MATTINGLY &  
HUNTLEY,  
ROBERT W. FULWIDER,  
WALTER P. HUNTLEY,  
JOHN M. LEE AND  
JOHN WEYL,

/s/ By WALTER P. HUNTLEY,  
Attorneys for Appellee.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed March 5, 1958. Paul P.  
O'Brien, Clerk.

No. 15893

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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~~CEL-REC~~ CHEMICAL Co., INC., a corporation,

*Appellant,*

*vs.*

~~DELCO~~ CHEMICALS, INC., a corporation,

*Appellee.*

---

## APPELLANT'S BRIEF.

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FILED

MAY 26 1958

PAUL P. O'BRIEN, CLERK





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No. 15893

IN THE

**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

CEE-BEE CHEMICAL Co., INC., a corporation,

*Appellant,*

*vs.*

DELCO CHEMICALS, INC., a corporation,

*Appellee.*

---

**APPELLANT'S BRIEF.**

---

**Statement of the Pleadings and Facts.**

The District Court had jurisdiction of this case under the Patent Laws of the United States (35 U. S. C., Sec. 281), and this Court has jurisdiction to review the judgment entered in this case. The pleadings conferring such jurisdiction are the Complaint [Tr. p. 3, *et seq.*], the Amended Answer and Counterclaim [Tr. p. 35, *et seq.*], and the Answer to Counterclaim [Tr. pp. 39-40].

This appeal is from a judgment granting appellee's Motion for Summary Judgment and holding that the patent in suit is invalid. The patent in suit, No. 2,653,116, covers a "Method of Removing Sealant from Integral Fuel Tanks" of aircraft. The Lower Court invalidated all the claims of this patent [Tr. p. 153].

This case was originally brought as a declaratory judgment suit, so the plaintiff in the Lower Court is the

accused infringer, and the defendant in the Lower Court is the owner of the patent in suit. The plaintiff-appellee brought the Motion for Summary Judgment in this case at the express invitation of the Lower Court [Tr. pp. 216-218], which invitation was not extended until eight days before the trial was set to begin [Tr. p. 216].

A jury was asked for by the patentee-defendant, but the Lower Court was very reluctant to try this case to a jury, since he has never tried a patent case to a jury and doesn't intend to until he has to [Tr. p. 218].

### Specification of Errors.

The points upon which appellant intends to rely on this appeal are as follows:

1.

The Court erred in granting plaintiff's Motion for Summary Judgment.

2.

The Court erred in entering judgment that the patent in suit, No. 2,653,116, is, and each of the claims thereof are, invalid and void.

3.

The Court erred in dismissing defendant's counter-claim.

4.

The Court erred in entering judgment for plaintiff's taxable costs herein.

5.

The Court erred in finding that no genuine issue as to any material fact existed in connection with the determination of plaintiff's Motion for Summary Judgment.

6.

The Court erred in finding that a soapy solution and a water-rinsable, solvent-miscible material are equivalent.

7.

The Court erred in finding that claims 1 to 3, inclusive, of the patent in suit specify a “soapy spray” for a tank before being rinsed, and that “soap” was applied before rinsing.

8.

The Court erred in finding that the prior art which the Commissioner of Patents failed to cite against the application for the patent in suit shows the method of the patent in suit to be old.

9.

The Court erred in finding that in Fig. 5 of Butterworth 2,018,757 the material is passed “through” a weir “or screen.”

10.

The Court erred in not applying said prior art specifically to the claims of the patent in suit.

11.

The Court erred in finding that extrinsic evidence is not needed to explain or evaluate the prior art cited by the plaintiff-appellee in this case, and its applicability to the subject matter of the patent in suit.

12.

The Court erred in finding that the patent in suit (a) does not produce any result not found in the prior art; (b) does not produce any unexpected result; and (c) does not produce any result greater or patentably different than the sum of the various steps or procedures of the prior art.



13.

The Court erred in finding that the patent in suit merely covered an old method of cleaning railroad tank cars, ship tanks, drums, or radiators.

14.

The Court erred in finding that the patent in suit, and each of its claims, lacks invention over the prior art, and is devoid of patentable novelty.

15.

The Court erred in concluding that there was no substantial dispute of fact as to any of the prior art patents.

16.

The Court erred in concluding that questions of anticipation in this case are questions of law.

17.

The Court erred in concluding that questions of want of invention in this case are questions of law.

18.

The Court erred in concluding that questions of validity in this case are questions of law.

19.

The Court erred in not holding that the depositions of Sydney G. Thornbury, Robert C. Bear, Thomas Edgin and C. R. Ursell raise issues of fact as to plaintiff-appellee's Motion for Summary Judgment.

20.

The Court erred in its interpretation of the file wrapper of the patent in suit.

21.

The Court erred in holding that the prior art cited in paragraph 12 of the Findings of Fact is closer than the prior art cited by the Examiner during prosecution

of the application for the present patent through the Patent Office.

22.

The Court erred in not holding that there is a presumption of validity of the patent in suit over said prior art because it is no closer than that cited by said Examiner.

23.

The Court erred in not holding that the prior art fails to show the step in the present patented method of applying a water-rinsable, solvent-miscible material.

24.

The Court erred in deciding, on a Motion for Summary Judgment, a disputed question of fact in connection with the nature, construction and operation of the weir shown and described in Butterworth patent 2,018,757.

25.

The Court erred in holding that the weir of Butterworth patent 2,018,757 is the equivalent of a screen, in the face of the issue of fact raised by defendant-appellant, to wit, that the nature and speed of travel of the solvent-soaked sealant would cause it to pass over a weir but be caught by a screen.

26.

The Court erred in taking "judicial notice of matters of general knowledge" without stating or showing where, or in what way, they were generally known.

27.

The Court erred in holding that "no fact finder could, within the bounds of reasonableness, find validity" in the Letters Patent No. 2,653,116, in suit.

28.

In apparently recognizing that there is "no 'strict anticipation'" of the patent in suit, and that there is "some

novelty” in same, the Court erred in deciding on a Motion for Summary Judgment the disputed question of fact of whether “a trained mechanic” would have solved the present problem “without difficulty” “at the time the invention was made.”

29.

The Court erred in holding that the present patented “cleaning process or method is common to many fields.”

30.

The Court erred in holding that the present patented method was “obvious” to one skilled in the art.

31.

The Court erred in holding that the patented method “is but a mere aggregation of steps long known and employed in the fuel-tank cleaning art.”

32.

The Court erred in not holding that the patent in suit covers an unobvious method that produces a new and useful result over the prior art cited.

### Only One Question on Appeal.

This entire appeal appears to hinge upon one question and only one question—is there any material issue of fact involved in this case? If there is none, it would seem that the Lower Court’s decision in granting the Motion for Summary Judgment would not *ipso facto* be reversible error. On the other hand, if there is at least one material issue of fact, then it would appear that it was reversible error for the Lower Court to have granted the Motion for Summary Judgment, and that this case should be reversed and remanded for trial.

## Are There Any Questions of Fact?

The effort of this Brief will be largely to point out that there is not merely one disputed question of material fact, but a long series of them, any one of which would appear to prevent determining this action on a Motion for Summary Judgment.

### Description of Patented and Prior Processes.

In order to appreciate the disputed issues of fact, a word of explanation of the present process would seem to be in order.

Wings of aircraft are now used for gasoline tanks. However, the gasoline would leak out between the metal-to-metal contact if these wing tanks were not sealed along the seams and around every rivet and bolt. This sealing material is synthetic rubber so as to permit bending of the wings while the aircraft is in flight, without the gasoline leaking out. After awhile, however, this sealing material, called "sealant," becomes hardened and works loose from the metal so as to cause leaks in the gasoline tank. The aircraft industry, by experience, knows about how long this sealant material will last, so, as a safety factor, before the gas tank begins to leak, the sealant is removed and fresh rubbery sealant is applied to all the seams and around all rivets and bolts in the tank.

The first efforts to remove this sealant were by workmen dressed in suits like "Men from Mars," which they wore to protect them from the gasoline fumes and scarcity of oxygen in the tanks. They had to be supplied with oxygen through hoses. In these cumbersome suits, they crawled into the cramped quarters of the wing tanks of aircraft, often only ten or eleven inches high, and, while lying down, laboriously chiseled out the hardened syn-

thetic-rubber-compound sealant, fragment by fragment. This took weeks of time because only one workman could reach a given area at one time, or only one workman could be in the relatively small tank at one time. This was not only expensive for workmen's time, but ground time for the average plane is considered as costing about \$4,000.00 per day.

Because of the difficulties of working under such adverse conditions, and because of the great expense of this method, a new desealing method was sought [Tr. p. 78].

Although patents were in existence at that time covering apparatus for cleaning out tank cars and ship hulls by spray means, it was apparently not obvious to those having ordinary skill in this art that the processes described therein would remove the sealant from aircraft tanks (and, as shown hereinafter, such processes would in fact not remove this sealant).

The next method tried was the "fill-soak-and-drain" method, whereby the aircraft fuel tank was filled to the top with the desealing solvent, permitting the sealant to soak for weeks and then the solvent was drained out with most of the sealant. Then the workmen had to crawl in, dressed in "Men-from-Mars" suits, supplied with air hoses in order to protect them from the highly toxic and often inflammable desealing fumes, and chisel out what always remained after such soaking.

The fill-soak-and-drain method was also time-consuming and very expensive. The fill-soak-and-drain method took 1200 man hours, about two weeks of ground time, and 3,000 gallons of expensive solvent costing about \$3.00 per gallon, for a C-54 or DC-4 plane.



With the industry in this condition, the method of the patent in suit was invented [Tr. p. 80].

The method of the patent in suit is quicker and far less expensive in man hours, gallons of solvent and ground time than the next best fill-soak-and-drain method. Said patented method will desal a C-54 or DC-4 plane with 500 man hours of labor, 600 gallons of solvent and five days' ground time. In other words, the saving in dollars effected by the patented method in an average desalting job on a C-54 or DC-4, as compared with any previous fill-and-soak-and-drain method, is about \$18,700.00, and the total saving to the United States Government by reason of the use of the patented method, over the said previous method, conservatively averages \$2,000,000.00 per year, making a total saving to the Government beginning in 1950, by the use of the patented method, of conservatively over \$12,000,000.00! [Tr. pp. 81-82].

The patented process, which is used by both the appellant and the appellee, finally fills the long-felt need for a less expensive, less hazardous, and quicker method for the removal of this sealant. The apparatus used includes spray means (something like lawn spray means) that are inserted in the tank. The tank is then sealed, and liquid solvent material is sprayed forcibly upon this sealant in the tank for a considerable period of time. The sealant soaks up the solvent gradually, causing the sealant to swell and to become spongy and jelly-like [Tr. pp. 95-96]. This swelling and the force of a relatively high pressure water rinse cause the sealant to loosen from the metal tank and wash the loosened pieces of sealant down the drain-hole in the tank. An entirely new, intermediate step between the solvent spray and the high pressure rinse is dealt with later in this brief.

### First Disputed Issue of Fact.

The Lower Court, by taking judicial notice of matters "of general knowledge," held that the present patented method was not new [Tr. p. 139]. Later, the Court said that the present process or method "is common to many fields" [Tr. p. 141].

The several depositions of Brigadier General James L. Jackson, Robert C. Bear, Thomas H. Edgin and Charles R. Ursell, would indicate that it was not common or general knowledge that the sealant could be removed from aircraft fuel tanks by any known methods, other than by laborious "hand-picking" or by the time-consuming and expensive "fill-soak-and-drain" method.

Brigadier General Jackson was one of America's outstanding Air Force officers during World War II. He stated under oath that such information was neither in common nor general knowledge for removing the rather peculiar sealant from aircraft fuel tanks. He specifically stated that there was a pressing need for several years for an improved method of desealing aircraft fuel tanks [Tr. p. 116]. "Many methods were tried and the vendors and mechanics in the trade worked upon the problems and suggested various methods . . . [but] no solution was found until . . . [defendant-appellant] demonstrated the operation of its recirculating spray method during the latter part of 1951." [Tr. pp. 113-115.]

When this method was first called to Brigadier General Jackson's attention, it was neither common nor general knowledge; in fact, he was "skeptical of it" and believed "that the mere spraying of chemicals through small apertures" would not "perform the job effectively" [Tr. p. 115]. He also considered the spraying of the sealant

(which is toxic to human beings) as “more dangerous than previous methods then in use.” [Tr. p. 115.]

Robert C. Bear, foreman of Capital Airlines, Washington, D. C., told of removing sealant from aircraft fuel tanks by the method that was in common use or general knowledge in this industry, to wit, filling the gas tank with the solvent, letting it soak, and then draining out the solvent and loosened sealant: the “fill-and-soak-drain” method. No other method was in common or general knowledge in the industry for removing sealant when the present method was invented by defendant-appellant’s assignors. Bear resisted the new patented method because “everybody was trying to get a new method and a better method, and none of them were any good” [Tr. p. 174]. However, the saving of man-hours—200 vs. 800—, the saving of elapsed time for desealing four DC-4 fuel tanks—55 hours vs. 192 hours—, the saving of expensive material—250 gallons vs. 1200 gallons—, and the safety to employees during desealing [Tr. pp. 175-176], removed the skepticism of this affiant as to the value of this new and different approach to the removal of sealant covered by the patent in suit.

Thomas H. Edgin, mechanical engineer at Tinker U. S. Air Force Base, Oklahoma, was at first “dubious” as to the present patented method of removing sealant, when it was first brought to his attention [Tr. p. 179]. It was in neither common nor general use in the industry. Neither was it obvious, for “numerous trial and error approaches were made” trying to remove sealant satisfactorily, but none of them was effective. Because of the toxic character of the solvent, they were attempting “to find a better method,” but with “very little positive results” [Tr. pp. 179-180]. He made tests comparing the

then generally known and used fill-soak-and-drain method with the patented method and found twenty-one advantages of the latter method over the old, previously known method [Tr. pp. 180-181]. These advantages are listed in detail [Tr. pp. 183-188].

Charles R. Ursell, maintenance engineer for many years for Pan American Airways, Brownsville, Texas, at the time that they were struggling with the old fill-soak-and-drain method, stated that in his opinion a person versed in the art of desealing aircraft integral fuel tanks would not ordinarily think of applying to a desealing operation a method similar to that used in railroad tanks and ships' hulls [Tr. pp. 194-195].

He gave several reasons for this: (1) different types of metal—aircraft are basically aluminum; lightweight and very thin material is used, whereas ships and railroad cars are basically steel and very heavy structure. The loss of any thickness of metal would not mean much in a ship or railroad tank car, but in an airplane "even 1/1000 of an inch is important to us." (2) different size of unit—"a ship or tank is a mammoth thing . . . [or] at least they are normally big enough for a man to get into, whereas an aircraft tank until the B-36 came along [had a] rather small hole in the fuel tank and normally a man couldn't even get into it. (3) At that time normally a hole would not be cut in the wing structure large enough for a man to get through because of the basic structure of the airplane" [Tr. pp. 194-195].

He too was at first skeptical of the new patented process, even though he had known of ships' hulls and railroad tank cars for many years. He said he was "as skeptical as a person can be, because of so many other ideas that were offered along the same line," but after

“viewing the end results” of the patented process, he was “impressed” and “amazed” with the results [Tr. p. 191].

The appellee has relied heavily upon Land patent No. 1,666,015 as showing common or general knowledge of the patented method in the trade. However, by the appellant’s showing, the Land patent was not considered as showing the common knowledge of the patented process, for Turco Products, Inc., the licensee of the Land patent from 1930 to the time it expired in 1945 [Tr. p. 204], took out a license under the patent in suit [Tr. pp. 117, *et seq.*] for a substantial sum (\$20,000 payable over a ten-year period). Turco Products, Inc. is one of the leaders of the chemical industry in the United States [Tr. p. 84]. At first, representatives of Turco Products, Inc. said the patented process “would not work” [Tr. p. 84]. It is submitted that this is evidence that the use of the patented method for the present purpose was not in common knowledge, or it would have been known by one of the largest concerns in this field in the United States, which was also the licensee under the Land patent (relied on by the appellee) and had full knowledge of it!

Although his company had been licensed under the Land patent for a number of years, Sydney G. Thornbury, president of Turco Products, Inc., thought the new patented process would not operate when he first heard of it, and resisted using the new patented method for several reasons [Tr. pp. 199-200].

The affidavit of Edward W. Giddings, vice-president of the defendant-appellant, outlined the method that really was in common and general use in this field when the present patented method came forward, to wit, the old fill-soak-and-drain method [Tr. p. 82]. The spray method was not in common or general use for cleaning aircraft gasoline tanks.



Rather than the patented method being in common or general knowledge, Vice-President Giddings stated that when this new method was proposed, the mechanics engaged in this field said that a mere spray could not remove the sealant because the latter was of a hard, synthetic-rubber-compound. Another objection by such mechanics (who are the ones who would have such "common or general" knowledge) was that the patented method would be more injurious to personnel than the old, then used, fill-soak-and-drain method [Tr. p. 83]. These objections proved incorrect, but they show that the patented method was not in common or general knowledge.

Thus, it appears that the Lower Court, after considering all this evidence, went ahead and decided this issue of fact in favor of appellee on a Motion for Summary Judgment.

As stated in *Hycon Mfg. Co. v. H. Koch & Sons*, 219 F. 2d 353 (C. A. 9), cert. den. 349 U. S. 953, 99 L. Ed. 1278, 75 S. Ct. 881, ". . . Any tendency to abolish trial in patent cases for consideration of documents in camera should be curbed"

### Second Disputed Question of Fact.

The second disputed question of fact is an extremely important one and pertains to what is shown in the prior patent upon which the appellee (and the Lower Court) relies most heavily in this case. That is the question of whether the dam or weir 38 of prior Butterworth patent No. 2,018,757 is a screen or is the equivalent of the screen 24 of the patent in suit. This prior patent, it should be noted, is the only one which the Lower Court discusses specifically [Tr. pp. 137-138], so its importance can, therefore, be gleaned.

The appellant's position, as shown by the sworn statement of its patent expert, William Douglas Sellers, is that, "*A weir is not a screen . . . With a screen, foreign particles are removed by not passing through the screen, while the remainder of the material passes through the screen. A weir more nearly approaches a dam . . . A weir requires a settling tank and a relatively large body of quiescent liquid, in order to permit settling*" behind the dam [Tr. pp. 109-110; emphasis added]. The Lower Court decided this disputed point against appellant by stating, "But this is not the teaching of non-cited Butterworth patent No. 2,018,757" [Tr. p. 138]. The Lower Court, it is submitted, fully recognized this dispute as to a matter of fact, and hence should never have proceeded to render judgment on the Motion for Summary Judgment.

Appellant's chemical expert, Keith R. Whitcomb, also adds to this disputed question of fact as to whether the Butterworth dam or weir is the same as, or the equivalent of, the screen in the patent in suit. He stated that the swollen pieces or strips of sealant that are removed from the interior of an aircraft fuel tank as "lightweight, slimy, gooey, jelly-like or sponge-like masses that are substantially the same specific gravity as the solvent, so that such pieces of swollen sealant are substantially held in suspension by the flowing solvent; that is, this spongy, lightweight sealant *neither descends nor rises* in the flowing solvent but is carried along by the solvent" [Tr. pp. 94-95; emphasis added].

The lightweight, non-sinking character of these pieces of sealant material is not the only factor that would render Butterworth's dam or weir inoperative for the present purpose. The material also travels so fast over the dam

or weir that the spongy, jelly-like pieces of sealant cannot settle behind the dam or weir, but are washed over the dam or weir “along with the rapidly moving solvent” [Tr. p. 95].

Here, then, we have the second strongly controverted issue of material fact (controverted by two of appellant’s affiants), to wit, whether Butterworth’s dam or weir will act as a screen in the patented process. The appellant’s position on this question of fact is that because of the non-sinking character of the swollen sealant and because of the rapid flow of the material, the floating sealant will wash right over Butterworth’s dam or weir and clog up the pump and spray in two to four minutes, thus rendering his entire system quickly inoperative [Tr. p. 95]. Due to the fact that there is a serious question as to whether the principal reference relied upon by the Lower Court is operative for the present purpose, here would seem definitely to be a material issue of fact.

It is believed that “it was error to hold that as a matter of law” the devices shown in the patent in suit and in the prior art are dissimilar or similar, where there is conflicting evidence. (See *Moist Cold Refrigerator Co., Inc. v. Lou Johnson Co., Inc.*, 249 F. 2d 246, 255 (C. A. 9, 1957) (reh. den.).)

### Third Disputed Issue of Fact.

The Lower Court stated that the prior-art patents not cited by the Patent Office “anticipated” the present patented process [Tr. p. 140]. It is presumed that the Lower Court meant that they anticipated the entire patented process. Obviously, there would not be “anticipation” if only part of the process were anticipated. The Patent Act itself requires that the subject matter “as

a whole” must have been obvious at the time the invention was made (35 U. S. C., Sec. 103). This raises the issue of fact as to whether the prior art patents anticipated the second step of appellant’s patented process. The appellant says they do not, the Lower Court says they do. To see the basis for this issue, claim 2 should be considered, which reads as follows:

“2. The method of removing the sealant from an aircraft integral fuel tank that comprises impinging a spray of volatile solvent against at least the upper portions of the sealant of the tank, simultaneously gravitationally draining free solvent from the tank with removed sealant material, *rendering the solvent water-rinsable by applying a substantially less volatile, water-rinsable, solvent-miscible spray to the solvent on the sealant*, and then applying water under substantially higher pressure than either spray to rinse free liquid of both sprayings, and removed sealant material, from the tank.” (Emphasis added.)

The second step emphasized above is best explained by stating that the patented process covers three steps: (1) spraying volatile solvent material against the sealant in the aircraft fuel tank; (2) applying less volatile, water-rinsable, solvent-miscible spray to the solvent on the sealant, in order to render the solvent rinsable by water; and (3) applying water under higher pressure to wash down the drain the loosened pieces of sealant. Claims 1, 2 and 3 of the patent in suit all cover this *second step* specifically.

The above second step is important for if the second step were omitted and water were applied after the first step, the solvent would merely be washed away and the sealant would “re-set” [Tr. p. 96]. The material used in this second step will both mix with the solvent (*i.e.*, is

“solvent-miscible”) and can be rinsed with water (*i.e.*, is “water-rinsable”). Water alone cannot accomplish both of these results.

An issue of fact arises over whether the soap solution of the prior patent to Foster 1,141,243 anticipates this step. Foster was cited by the Examiner during the prosecution of the patent in suit through the Patent Office; no other patent cited by the appellee or the Lower Court appears to show even a soapy solution for washing out a tank.

However, soap or a soapy solution is not solvent-miscible, and would not prevent the sealant from returning to a hardened material and to a water-insoluble material. In fact, soap or a soapy solution would wash away the solvent and cause the sealant to re-set as a hardened rubber compound. Thus, soap or a soapy solution would be inoperative and produce just the opposite results from those desired [Tr. pp. 96-97]. The salt water and caustic soda of Butterworth 2,018,757 is also not solvent-miscible, and instead of removing sealant that is saturated with solvent, such “cleansing liquid” would wash out the solvent and tend to re-set the sealant against the wall of the fuel tank in hardened masses [Tr. p. 97].

The Lower Court found in Finding of Fact 11 [Tr. p. 148] that claim 1 of the patent in suit “specifies that the tank is given a *soapy* spray before being rinsed” (emphasis added). This, it is submitted, is clearly contrary to the affidavit of the appellant’s chemical expert, as stated in the next preceding paragraph herein, and is definitely a decision by the Lower Court on a hotly disputed issue of fact. This determination alone appears sufficient basis for reversing the Lower Court in this case.



It is not denied by either the appellee or the Lower Court that this second step in the patented process is an important one, which it certainly is for the reasons stated. Whether this second step accompanies or precedes the third washing step, the prior art should show this second step or there is no "anticipation."

The Lower Court held in Conclusion of Law 3 [Tr. pp. 152-153] that extrinsic evidence was not required to explain the prior art. The Court is believed clearly erroneous in this, for an explanation is necessary to understand that the prior art does not show anything that would take the place of the present patented second step. The fact that the Lower Court apparently never understood this lack of anticipation is ample evidence that extrinsic evidence was necessary for explanation.

The affidavit of the appellant's patent expert, William Douglas Sellers, states as a fact that none of the prior patents relied on by appellee herein teaches the use of a "less volatile" emulsifier that is "solvent-miscible" between the use of a volatile solvent and just water [Tr. p. 107]. None of the prior art in this case has or suggests appellant's patented "three-step method" [Tr. p. 107].

This second step produces the result of rendering the solvent miscible with water. As shown, this is not found in any of the prior art. However, the Lower Court, again, decided a disputed issue of fact by finding in Finding of Fact 21 [Tr. pp. 151-152] that the present patented method did not produce any result not produced in the prior art. Of course, the Lower Court should not have decided this issue of fact on a Motion for Summary Judgment, in the face of a *contra* affidavit by a patent lawyer.

The affidavit of a patent lawyer that brochures did not contain any disclosure of the details shown and claimed in the claims of the patent in suit raised "an issue of fact which must be determined."

*Panaview Door & Window Co. v. Van Ness*, 135 Fed. Supp. 253 (D. C. S. D. Cal., 1955, Jertberg, J.).

Thus, it is submitted that, whether this second step is anticipated by the prior art is an issue of fact submitted to the Lower Court as being one squarely opposed by the parties. On a Motion for Summary Judgment, it does not seem that the Lower Court should have decided this question of fact.

It is believed that the Lower Court was in error in not applying the prior art specifically to the claims of the patent in suit (10th Specification of Error, *supra*).

The Court in its Decision stated:

"It would serve no useful purpose to labor here the detail of a comparison of the essential steps embraced by the cleaning methods disclosed in the prior-art patents involved here, both cited and uncited."  
[Tr. p. 139.]

If the Court had specifically made a point-by-point application of the prior art to the claims in suit, it is believed that it would have been more conscious of the omission by all the prior art, cited and uncited, of this second step.

Because of this very important second step, and because it is quite technical as to why the water or steam of the prior art would be detrimental and would not perform the same purpose, it is believed that the Lower Court was in error in holding that "extrinsic evidence"

was not needed for the purpose of explanation of the prior art [Tr. p. 137]. This is the 11th Specification of Error, *supra*.

#### Fourth Disputed Issue of Fact.

The Lower Court also made a decision as to a fourth disputed issue of fact, to wit, that the method of the patent in suit is “but a mere aggregation of *steps long known* and employed in the fuel-tank cleaning art.” [Tr. p. 142; emphasis added.]

It is one of appellant’s strongest arguments that the second step, considered more thoroughly hereinbefore, was never before known in the fuel tank—, or any other tank—cleaning art. The sealant is a different material than heretofore encountered in cleaning out a tank. It is a synthetic-rubber-compound that has hardened in place and it takes a week or two of constant soaking to loosen it [Tr. p. 83]. It is not like milk, molasses, or other material that can be removed by hot water or steam. Water or steam would be objectionable in removing aircraft tank sealant, for they would merely wash away solvent and re-set the rubber sealant.

Thus, the second step of the patented process is believed to be entirely new in the removal of sealant (or any other material) from a tank. What is even more important, the prior art relied upon by the appellee and by the Lower Court does not in any way, shape or form anticipate or even suggest the said second step!

Thus, the Lower Court is believed to have decided this case on what it believes to be the merits of the case, rather than recognizing that there is a sharp issue of fact as to whether the second step of the patented process is suggested by a single one of the prior art references.

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Thus, the Lower Court is believed to have decided this case on what it believes to be the merits of the case, rather than recognizing that there is a sharp issue of fact as to whether the second step of the patented process is suggested by a single one of the prior art references.



### Fifth Disputed Issue of Fact.

Fifth, the Lower Court held that “the patents not cited by the Examiner are decidedly more pertinent to the precise art of the claimed invention than those which were cited” [Tr. p. 139]. Here, the Court was again actually *deciding* a disputed question of fact. Appellant’s patent expert, William Douglas Sellers, has averred under oath that the patents not cited by the Examiner and relied upon by the appellee herein “are no more relevant or persuasive of non-invention” in the patent in suit, than the “patents cited by the Examiner” [Tr. p. 100]. An example of this is the fact that the “soapy-spray” Foster patent, cited by the Examiner, is the only prior patent relied on which introduces anything other than water, steam or caustic soda, to clean a receptacle. If anything, this Foster patent is closer than any of the non-cited art relied upon by the appellee.

The appellee, of course, takes a contrary view on this question of fact (or its entire case upon which the Lower Court granted the Motion for Summary Judgment collapses). *The Lower Court’s decision depends entirely upon its decision on this question of fact.* If the appellant’s expert is correct that the references relied upon by the appellee are no closer than those cited by the Examiner, then the patent in suit would be presumed to be valid over the prior patented art, and the Motion for Summary Judgment would fail.

It is believed that the Lower Court was clearly erroneous in asserting a half-truth in Conclusion of Law 2 [Tr. p. 152] to the effect that there is no presumption of validity as to prior art not cited by the Patent Office. It is felt that the Lower Court should have said that

there is no presumption of validity as to prior art that is *closer to the patent in suit* than the prior art cited by the Patent Office.

This, then, is believed to be the fifth disputed question of fact which should not have been (but which was) decided by the Lower Court on a Motion for Summary Judgment.

### Sixth Disputed Issue of Fact.

The Lower Court also held in its decision that the whole of the present patented method does not exceed “the sum of its parts” [Tr. p. 142]. Here again, the Lower Court is overlooking evidence that the method does exceed the sum of its parts, as follows:

Prior to the advent of the present patented process, the “stringers” of airplanes could not be cleaned except by removing same. Stringers are the long, narrow, hollow, strengthening members that extend throughout the length of the airplane wings [Tr. p. 92].

It was thought that it was impossible to clean these stringers. The Wyandotte Chemical Co., a large chemical concern, made a study of this problem, at a cost of \$150,000, for the United States Air Force, and their conclusion was that it was impossible to clean the stringers unless the wings of the aircraft were rebuilt [Tr. p. 93]. Then, along came the present patented process which successfully cleaned the stringers for the first time without rebuilding the wings. So, now, the United States Air Force requires the stringers to be cleaned when desealing an aircraft fuel tank. Thus, the standards for desealing jobs done for the United States Government have been materially raised by this unexpected result of

the patented method. This is believed to be evidence that a result is obtained that is greater than the sum of its parts.

Another result was that the fine vapors or fumes from the spray of the patented process produced an unexpected dividend! Contrary to what was expected, it was possible to reach areas effectively with the fumes where the solvent in liquid form would not go [Tr. p. 204].

Still another unexpected advantage of the patented method was that there is heat generated by impingement of the spray upon the sealant, which heat causes volatilization of the solvent at the very point where needed [Tr. p. 92].

These several unexpected results are all evidence that the sum total of the steps of the patented method is greater than its parts. At least, it is believed that the Lower Court should not have made a decision on this point on a Motion for Summary Judgment, when there is evidence to the contrary. The question, "Does the whole exceed the sum of its parts?" is definitely a question of fact.

It is believed that the Lower Court was too anxious to decide the present case. As the Lower Court said in another case, "I am ready to entertain a motion for summary judgment on the issue of validity in any patent case" [Tr. p. 128].

### **Implied Concessions by Lower Court.**

There are hints in the Decision that the Lower Court itself is not too convinced that all the steps of the present patented method are old and of "general knowledge" [Tr. p. 139], or that the method is "common to many

fields” [Tr. p. 141]. In fact, elsewhere in the Decision, there is not one, but four hints that all is not well with these somewhat inconsistent statements of the Lower Court.

First, the Lower Court stated that, “Even if it be said that there appears no ‘strict anticipation’ of the patent in suit, and that the method involves some novelty . . .” The Court then cites an authority that, “although there is no strict anticipation and even though the . . . [methods] involved may not be similar . . .” [Tr. p. 140].

The second suggestion of doubt as to whether every one of the steps of the patented process is of “general knowledge” or “common to many fields,” comes in the Court’s next citation, to the effect that no invention is ordinarily involved “even though changes and modifications are essential to the practical application of the method . . . to the new use” [Tr. p. 141].

The third hint comes on page 144 of the Transcript of Record, in the Court’s statement that the patent in suit is invalid for strict anticipation, “or, in any event, for want of patentable novelty.”

Lastly, the Lower Court concludes, “So in the case at bar, even if the disclosures of the non-cited-prior-art patents be said to fall short of complete anticipation . . .” [Tr. p. 144].

The Decision, therefore, appears somewhat indefinite as to whether the Lower Court’s position is that the patented method is old because of general knowledge and because it is common to many fields, or that even though the patented method is different than used in any other field, nevertheless no one “within the bounds of reasonableness, could find validity here” [Tr. p. 140].

## Seventh Question of Fact or Mixed Question of Law and Fact.

The Lower Court had presented to it here the question of whether the admitted improvement which the patented method made over the prior art (the new second step) was mere mechanical skill or required the exercise of the faculty of invention. It is submitted that this was a question of fact and should have been left for the determination of the jury, and not decided by the Lower Court. See the following quotation from *Thomson v. Ford Motor Co.*, 265 U. S. 445, 446, given by Pope, J., in his concurring opinion in *Bergman v. Aluminum Lock Shingle Corp.*, 251 F. 2d 801, 116 U. S. P. Q. 32, 39 (C. A. 9, 1957):

“The question whether an improvement requires mere mechanical skill or the exercise of the faculty of invention, is one of fact; and in an action at law for infringement is to be left to the determination of the jury.’ ”

In accordance with the case of *Hansen v. Safeway Stores, Inc.*, 238 F. 2d 336, 339 (C. A. 9, 1956), it is believed that the appellant here should not be deprived of its constitutional rights under Article VI of the Constitution to a trial by jury, for the questions of novelty and invention are questions of fact and should be tried by a jury.

“And invention is a question of fact, in ordinary circumstances such as are found here.”

*Hutchens v. Faas*, 249 F. 2d 465 (C. A. 9, 1957).

The circumstances in the instant case are ordinary to say the least.



The question of validity of a patent claim is one of fact.

*Stauffer v. Slenderella Systems of Cal., Inc.*, 115 U. S. P. Q. 347 (C. A. 9, 1957), citing a long list of Ninth Circuit cases to the same effect.

“In summary, this court has consistently held that the question of validity of a claim of a patent is one of fact.”

*Container Corp. of America v. M.C.S. Corp.*, 250 F. 2d 707 (C. A. 9, 1957).

“ . . . the question of novelty and invention is one of fact as to which the conventional clearly erroneous test is applicable.”

*Oriental Foods, Inc. v. Chun King Sales, Inc.*, 244 F. 2d 909 (C. A. 9, 1957).

At the most, the question of invention is a mixed question of law and fact. See the earlier case of *Hycon Mfg. Co. v. H. Koch & Sons*, 219 F. 2d 353 (C. A. 9, 1955), cert. den. 349 U. S. 953, 99 L. Ed. 1278, 75 S. Ct. 881:

“ . . . But the utmost which can be said in a patent validity case is that it is a ‘mixed question of law and fact.’ ”

Whether the changes made by appellant’s assignors over the prior art constituted mere mechanical skill or required invention, therefore, should not have been decided on a Motion for Summary Judgment because of the opposing contentions of the appellant and appellee. As stated in the *Hycon* case, *supra*, “Both contentions of fact could not be true.”

The Lower Court held that even though the present process may be novel, nevertheless it would have been

foreseen by a mechanic trained in the art [Tr. pp. 140-141]. Nothing could be more clearly a decision on a question of fact than this. The bulk of appellant's evidence was submitted for the purpose of showing that the patent was not, as a matter of fact, and could not have been, foreseen by a mechanic trained in the art. The appellant presented evidence as stated to show that three trained mechanics and one General of the United States Air Force in charge of maintenance and repairs of aircraft, did not conceive of the patented process, and were in fact surprised when it operated successfully. The Lower Court chose to believe contrary to this evidence, which is a clear-cut, fact-finding process.

The Lower Court states that where a method is common to many fields, its application to a new field "ordinarily" involves no more than mechanical skill [Tr. p. 141]. But the question here is whether or not in this case and under these circumstances—not ordinarily—no more than mechanical skill was involved, and it is thought that question cannot be answered except by an evaluation of evidence presented at a plenary trial.

In citing *Dow Chemical Co. v. Halliburton Oil Well Cementing Co.*, 324 U. S. 320, the Lower Court indicates that the present patent monopoly should not be sustained because it contributes so "insubstantially" to the fund of public knowledge [Tr. p. 142]. Here, the Court is deciding what is substantial and what is not substantial. This is a clear evaluation of facts, not thought to be permitted on a Motion for Summary Judgment.

### Eighth Disputed Issue of Fact.

The Trial Court's Finding of Fact 8 [Tr. p. 147] states as a fact that the subject matter of the patent in suit was treated and considered by both the Commissioner of Patents and the applicants (appellant's assignors) as being within and analogous to the general art of tank cleaning. Apparently it is the position of the Lower Court that this was an admission of fact against interest made by applicants for the patent in suit.

Here, however, is another disputed issue of fact. The appellant contends, and the affidavit of the patent expert William Douglas Sellers is, *contra* to this holding of the Lower Court. The said patent expert stated [Tr. p. 110]:

“Patents in that field were cited by the Examiner and it was at *all* times contended by the attorney of record that they did not anticipate the claims now in the patent in suit . . .” (Emphasis added.)

Instead of the record showing that the Commissioner in the end held that the patent in suit was in the general art of tank cleaning, on the contrary, after the argument was made by the patentees' attorney,

“ . . . the Examiner impliedly admitted the soundness of such argument by allowing the patent in suit despite such prior patented cleaning apparatus.” [Tr. pp. 110-111.]

This, then, is another disputed issue of fact: does the file wrapper comprise an admission by the Examiner that the ordinary tank cleaning art does not anticipate, or is it an estoppel by the patentees that it does apply?

### An Over-all Disputed Issue of Fact.

It is believed clear from the foregoing that it is a material issue of fact of over-all importance as to whether or not the patented process "as a whole" was "obvious at the time the invention was made, to a person having ordinary skill in the art." (35 U. S. C., Sec. 103.)

Evidence that it was not obvious runs throughout the record. There is also specific evidence in the record that the present patented method was not obvious because in a sense the present method is "exactly opposite" to the tank cleaning processes of the prior art [Tr. p. 79].

The affiant Edward W. Giddings, Vice-President of the appellant, avers that tank cars or ship hull cleaning is different than removing sealant from aircraft fuel tanks. Oil, asphalt or scale are not intended to be and are not normally part of a tank or ship, and they are removed as foreign substances as soon as possible [Tr. p. 79]. On the other hand, sealant is a normal, permanent part that is built right into the aircraft, and removing it is a step in repairing it, for new sealant is replaced in the fuel tank as soon as the old sealant is removed [Tr. p. 79]. "An aircraft cannot be flown without the sealant," he states. "It is an integral part of the aircraft. The oily or asphalt residue or scale are detriments to the tank car or ship and should be removed, the sooner the better." [Tr. p. 79.]

The patent expert Sellers puts it another way. He likens washing milk or oil from a tank, to washing dirt from the side of a stucco house with a hose. He avers that in his opinion such a washing process is distinct from the unique discovery that such technique is suitable for removing permanent stucco, which would appear not removable by a hose [Tr. pp. 108-109].

### Lower Court Disregards Issues of Fact.

The Lower Court disregarded a number of issues of fact presented to it.

The affidavit of George H. Boeck [Tr. pp. 73-75] states that of his personal knowledge Exhibits K, L and M were reproduced in quantity and given by him and other Oakite representatives to "many customers and prospective customers." The *contra* affidavit of Vesta M. Nelson [Tr. pp. 121-124] shows that in a subsequent conversation, the said George H. Boeck admitted that he had no personal knowledge of the quantities that were produced or what distribution, if any, was made by the other representatives of Oakite.

A sharp issue of fact arises as to whether there was a general or limited distribution of Appellee's Exhibits G, H, K, L and M. Obviously, if there were no general circulation, they can hardly be said to be publications. The only ones to whom George H. Boeck gave copies were those customers or prospective customers to whom he fully explained the whole construction. The few copies that were purportedly given out by Mr. Boeck did not constitute a "general" circulation thereof. Mr. Boeck, himself, gave out only six copies of Exhibit M down to 1953. Since 1945 is the earliest date or copyright date on said exhibits, it would appear that in the eleven years from 1945 to 1956, Mr. Boeck gave out Exhibits G, H, K and L on an average of a little less than one per year to an average of less than one and one-half per year as the top figure. He gave out Exhibits G and H only when they were attached to Exhibits K and L. It is submitted that a genuine issue of material fact is raised as to whether Mr. Boeck did in fact circulate these exhibits to



“many customers and prospective customers” or whether they were shown only to a few customers and prospective customers in a very limited, restricted way. Sending copies of photographs to dealers for the purpose of enabling them to give orders is not a publication. (See *Falk v. Gast Lithographing and Engraving Co.*, 54 Fed. 890, 893 (C. A. 2).) At the very most, the only purpose of Mr. Boeck showing the drawings and written description to his customers was to enable them to make purchases of equipment therefor from Oakite Products, Inc.

This conflict of testimony raises a question as to the credibility of Boeck’s entire affidavit, relied upon by the appellee. The credibility of an affiant raises a genuine issue of material fact. See the Supreme Court case of *Sartor v. Arkansas Natural Gas Corp.*, 321 U. S. 620, 88 L. Ed. 967, 973, 64 S. Ct. 724 (1944), which is quoted or cited several times in Ninth Circuit cases in decisions on motions for summary judgment, and is a leading case on the subject.

A genuine issue of credibility should not be resolved on a Motion for Summary Judgment. See *Moore’s Federal Practice*, 2d Ed., Vol. 6, p. 2139:

“The general and well settled rule is that the court should not resolve a genuine issue of credibility at the hearing on the motion for summary judgment, whether the case be a jury or court case; and if such an issue is present the motion should be denied and the issue resolved at trial by the appropriate trier of the facts, where, to the extent that witnesses are available, he will have the opportunity to observe their demeanor.”

### Issue of Fact as to Exhibit H.

The appellee asked in its Counter-Designation that Exhibit H, Directions of Oakite Products, Inc., be printed *in extenso* in the Transcript of Record. The fact that it is approximately twenty-two pages long and is the longest single item in the entire record, may give some idea of the prominence which appellee attaches to it. Exhibits F, I, K, L and M relate to the Oakite matter also. It is believed that issues of fact based on these six different exhibits should not be disregarded.

Exhibit H states that it uses “a cylindrical strainer” that is “fine mesh” and with “an area of not less than 3 sq. ft. of 10 mesh wire.” This fine mesh strainer is in every suction line that leads “from each tank to the intake opening of the pump” [Tr. pp. 56-57].

The appellant’s chemical expert Whitcomb avers that this Oakite construction “would not screen out ‘sealant from the solvent’ as specifically covered in most of the claims of the patent in suit” and that the Oakite apparatus “would be clogged by the swollen, spongy sealant in about two minutes” if used to try to remove such sealant in the patented process [Tr. pp. 95-96].

Here we seem to have another strongly controverted issue of fact that should not have been avoided by the Lower Court.

### Lower Court Cannot Merely Decide What It Considers “Dispositive.”

The Lower Court sidestepped all the foregoing issues with regard to Boeck’s affidavit and the operability of the Oakite reference by merely saying that it only needed to adjudicate “a single issue which is dispositive of the

case” [Tr. pp. 144-145], citing Fourth and Seventh Circuit cases and a decision of the Lower Court itself along the same line in another case, which was not appealed to this Court. However, it is believed that this Circuit has a different rule:

“On summary judgment an issue of fact cannot be disregarded because the trial judge believed some other issue was decisive. Such a course would lead to multiple appeals of the case.”

*Gillespie v. Norris*, 231 F. 2d 881, 883-884 (C. A. 9, 1956).

Thus, it appears that because of this alone, the Lower Court’s Decision should be reversed and remanded for a trial of disputed issues, including both that which the Court considers dispositive and the other issues of fact as well.

### Court’s Reaction.

Because of the Lower Court’s crowded calendar, appellant has every sympathy with such Court trying to short-circuit a jury trial, but it is believed that the Lower Court erred in “short cutting” this case. This Honorable Court in *Hycon Mfg. Co. v. H. Koch & Sons*, 219 F. 2d 353, 355 (C. A. 9, 1955), cert. den. 349 U. S. 953, 99 L. Ed. 1278, 75 S. Ct. 881, cautioned lower courts in this Circuit against granting motions for summary judgment when there is a dispute about a fact:

“. . . It is realized that the learned trial judge took this action under the pressure of a heavy calendar and in order to save time for the parties and attorneys. As often happens, the shortcut did not accomplish the desired end. . . .”

The Lower Court had a different view, as to granting a jury trial, in another case. It stated, in said other case, "I am favorably disposed to grant a jury trial to anyone who wants a trial by jury, even in a patent case." [Tr. p. 126.]

Furthermore, the Lower Court said in said other case:

" . . . I agree wholeheartedly with the remarks of Judge Learned Hand with respect to the elusiveness of the non-existent standard for the determination of what is invention.

"Now, I daresay that most juries know just about as much about it as most judges." [Tr. p. 126.]

Also:

" . . . And with all due deference, as far as I am concerned, I think 13 people sitting over there in the box know just about as much about it as I do." [Tr. pp. 127-128.]

### **Lower Court Relies on Abandoned Position of Patent Office Examiner.**

The Lower Court refers to the earlier, tentative holding of the Examiner in the Patent Office that at that time (December 2, 1952) the Examiner's opinion was that " . . . separation by settling is considered the full patentable equivalent of . . . [applicants'] screens" [Tr. p. 138].

The Lower Court took this statement to be the ultimate decision of the Examiner. It should have been noted, however, that the Examiner reversed this first ruling after considering the affidavit of the chemical expert Keith R. Whitcomb, dated July 7, 1953 and filed with the amendment of July 15, 1953. This affidavit distinctly

pointed out that the Butterworth patent cited by the Examiner would not operate for the present purpose since settling would not remove the swollen sealant from the solvent because the swollen sealant would be,

“ . . . held in suspension, since it has approximately the same specific gravity as the cleaning fluid; thus the swollen solvent neither rises nor settles. Moreover, the circulation of the fluid in applicants' process is so rapid, as to absolutely prevent settling . . . but the cleaner or solvent circulates at the rate of 150 gallons per minute, so that settling is absolutely prevented.” [See file wrapper, filed herein as a physical exhibit.]

In due course, the Examiner, after considering the foregoing affidavit, giving the reasons why a settling tank was not the patentable equivalent of the applicants' screens, reversed himself and allowed the claims of the patent in suit.

This is believed to be a full answer to the Lower Court's exclamation, “One reads the file wrapper and wonders upon what possible ground the letters in suit issued, even over the prior art cited.” [Tr. p. 140.]

Thus, the Lower Court bases its decision on an earlier, abandoned position of the Examiner, in deciding this disputed question of fact (as to the possible equivalence of screens and weirs).

### **Patent in Suit Carefully Considered by Patent Office.**

The Lower Court commented (apparently in derogation of the patent in suit) that the application for the patent in suit was “at length” allowed after amendment of the original claims, after personal interviews with the Examiner, and after associate counsel appeared [Tr.



p. 131]. Instead of detracting from the value of the patent in suit, it is believed that all this shows that the patent in suit was not carelessly or haphazardly granted, but that it was issued only after full and careful examination of the application by the Examiner in the Patent Office. It would appear that the Lower Court should have been more reluctant, not less reluctant, to strike down a patent in a summary proceeding that had been given such serious and prolonged study by the experts in the Patent Office.

The presumption of validity is strengthened when there were extensive administrative proceedings concerned with prior art.

*Otto v. Koppers Co., Inc.*, 246 F. 2d 789 (C. A. 4, 1957).

### Lower Court Holds Evidence “Undisputed.”

In its quotation from *Mettler v. Peabody Eng. Corp.*, 77 F. 2d 56 (C. A. 9), [Tr. p. 140], the Lower Court recognizes that there must be clear, “undisputed” evidence of anticipation by the prior art not cited by the Patent Office, to overcome the presumption of validity of an issued patent. Certainly the appellant, while defendant in the Lower Court, forcefully disputed the question of anticipation by the non-cited prior art—see the foregoing arguments with regard to: (1) the present process not being in common use or in general knowledge; (2) the novel second step of the patented process; (3) the “weir” of Butterworth patent 2,018,757; (4) the “soapy” solution; and (5) the operativeness of the Oakite construction.

These points were anything but “undisputed,” and the Lower Court had to make a decision as to each of these

disputed questions of fact before it could hold that the patented process was anticipated. These issues, it is submitted, should have been decided only after a plenary trial.

### Lower Court Applies Wrong Criteria.

The Lower Court stated that no fact finder could “within the bounds of reasonableness” find validity here [Tr. p. 140], and decided to render a decision in this case on a Motion for Summary Judgment if it could understand the patent in suit and the prior art [Tr. p. 217 and see “easily understood,” Tr. p. 136]. It is submitted that on a Motion for Summary Judgment the questions of “reasonableness,” or whether the patent in suit and the prior art could be understood by the Court, are not the proper criteria. The only question before the Court in such summary proceeding is, “Does there exist a dispute as to any material question of fact?”

### Conclusion.

It is submitted that the Lower Court, in taking a short cut in this case, has decided numerous, disputed, material questions of fact on a Motion for Summary Judgment. This is thought to be clearly erroneous. For the many reasons given hereinbefore, it is believed that the Judgment should be reversed and remanded, in order to have a plenary trial upon the many controverted issues of fact.

Respectfully submitted,

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*Attorneys for Appellant.*

No. 15,893

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

CEE-BEE CHEMICAL Co., INC., a corporation,

*Appellant,*

*vs.*

DELCO CHEMICALS, INC., a corporation,

*Appellee.*

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## APPELLEE'S BRIEF.

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**FILED**

JUL 23 1958

PAUL P. O'BRIEN; CLERK



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DELCO CHEMICALS, INC., a corporation,

*Appellee.*

---

## APPELLEE'S BRIEF.

---

This is an appeal by Defendant below from a final judgment of the United States District Court for the Southern District of California, Central Division, in an action for Declaratory Judgment in which the District Court held invalid and void the Whitcomb *et al.* Patent No. 2,653,116, owned by said Defendant-Appellant.

## JURISDICTION.

Jurisdiction to hear and determine the issues raised by the Complaint [R. 3], Answer and Counterclaim [R. 35], and Reply [R. 39], was vested in the District Court by 28 U. S. C. 1338(a), 2201, and 2202, and 35 U. S. C. 281. In the exercise of that jurisdiction, the District Court granted [R. 130-145] Plaintiff's Motion for Summary Judgment [R. 42] and entered its Final Judgment [R. 145] dismissing Defendant's counterclaim for patent

infringement and adjudicating invalid and void the Whitcomb *et al.* Patent No. 2,653,116 [R. 226] in suit and each of the claims thereof. The Final Judgment was entered December 30, 1957, and Appellant filed its Notice of Appeal [R. 154] on January 8, 1958. Jurisdiction to review the appealed judgment is vested in this court by 28 U. S. C. 1291.

### STATEMENT OF THE CASE.

This is an action by Appellee-Plaintiff, the alleged infringer of Whitcomb *et al.* Patent No. 2,653,116 [R. 226], owned by Appellant-Defendant, for a judicial declaration under 28 U. S. C. 2201 and 2202 that said Patent is invalid and void and not infringed. (Plaintiff's Complaint [R. 3] set forth additionally a count for unfair competition and another count for anti-trust violation, but these two counts were dismissed on stipulation [R. 41] during the preliminary phases of the litigation.)

Defendant's Answer [R. 35], which consisted primarily of a denial of the matters alleged in the Complaint, contained a Counterclaim [R. 36] charging Appellee-Plaintiff with infringement of said Patent No. 2,653,116 [R. 226]. Appellee-Plaintiff's Reply [R. 39] to this Counterclaim set up the defenses usually urged in a patent infringement case.

This litigation thus amounts to an ordinary patent infringement action with the parties reversed; *i.e.*, in this case, the patent owner is the defendant, and the plaintiff is the party charged to infringe. The case is also somewhat out of the ordinary in that the patent owner (Appellant-Defendant) requested a jury trial [R. 38].

At a pretrial conference, the District Judge, having a reasonable familiarity with the case by reason of certain



preliminary proceedings and certain affidavits and exhibits filed by Plaintiff in connection with an earlier Motion for a Preliminary Injunction [see Ref. R. 33], indicated that a Motion for Summary Judgment would not be out of order, and might afford an opportunity to reach a final judgment in the case without spending the time, energy and money which would be required for a full trial to a jury [R. 215-220]. Plaintiff thereupon moved [R. 42] for Summary Judgment dismissing Defendant's Counterclaim for patent infringement and declaring the patent in suit to be invalid and not infringed. This Motion was granted, a Memorandum of Decision [R. 130-145] was filed and entered, and in due course a corresponding Final Judgment [R. 153] accompanied by appropriate Findings of Fact and Conclusions of Law [R. 145] was made and entered in the case; Defendant appealed [R. 154].

### QUESTIONS PRESENTED.

Appellant's Points on Appeal [R. 160] set out thirty-eight alleged errors, and the Specification of Errors in its Brief (Br. p. 2) recites some thirty-two alleged errors. The absurdity is apparent and suggests strongly that Appellant does not have a single sound ground for its appeal and is attempting to make up in quantity what it lacks in quality.

Appellant's thirty-two errors seem to be alleged *in vacuo*,—Appellant states (Br. p. 6) that there is only one question on this Appeal—" . . . is there any material issue of fact involved in this case?"

Notwithstanding Appellant's contention, Appellee submits that the obvious invalidity of the patent in suit is the first and most important matter to be considered on this appeal. When it is shown that the Court below cor-

rectly decided this substantive question, it answers any question Appellant could raise on the procedural matter of entering a final judgment of invalidity on a Motion for Summary Judgment.

This Appeal thus presents two questions: a first and substantive question of whether the District Court was correct in holding the patent in suit invalid; and a second and procedural question of whether there exists a genuine issue of material fact of such kind and character as to preclude an affirmative answer to the first question.

### SUMMARY STATEMENT OF FACTS.

Appellant-Defendant Cee-Bee Chemical Co., Inc., is a California corporation [R. 4], and Appellee-Plaintiff Delco Chemicals, Inc., is a Delaware corporation [R. 3]; both parties have principal places of business in the County of Los Angeles, State of California. Appellant is the owner [R. 37] of Whitcomb *et al.* Patent No. 2,653,116 [R. 226] which was issued on September 23, 1953.

A bona fide dispute exists between the parties as to the validity of the patent in suit [R. 4] and Appellee represents to the Court that there is no genuine issue as to any material fact necessary to the consideration and determination of the question of the validity of said patent.

The patent in suit [R. 226] relates to the cleaning of tanks, its stated object being to remove coatings of sealant material from airplane fuel tanks by the claimed method or procedure of spraying a suitable solvent against the upper parts of the tank walls, allowing the sprayed solvent and any loosened sealant particles to drain out of the tank by gravity, screening the drained solvent to separate from it any sealant particles, and then recirculating the screened solvent through the sprays, after which a water

rinse is applied to the tank as is customary in cleaning operations.

Appellant has charged [R. 37] that Appellee has infringed the patent in suit by practicing the method thereof, and by making, selling and using apparatus adapted for, intended for, and actually used for the purpose of practicing such method. Appellant so notified Appellee [R. 38], a controversy ensued [R. 4], and Appellee brought this action [R. 3] for declaratory relief seeking a declaration of its right to continue by reason of the invalidity of the patent in suit.

The patent in suit [R. 226] issued September 22, 1953, on application filed March 16, 1949, by Keith R. Whitcomb and Eugene E. Finch as joint inventors, the application and the patent being assigned [see Ref. R. 227] by the inventors to appellant Cee-Bee Chemical Co., Inc. During its pendency in the Patent Office, the application was rejected four times and was five times amended before it was finally allowed and issued as a patent [see Ex. B, a physical exhibit, referred to at R. 156(29), 167(1), and R. 44].

In allowing the Whitcomb *et al.* application and issuing the patent in suit, the Patent Office cited [R. 229] and considered only the following references:

Butterworth	<i>Re</i> 19,374 [R. 231]
Foster	1,141,243 [R. 236]
Gray	1,628,141 [R. 245]
Haupt	1,892,950 [R. 249]
McFadden	2,092,321 [R. 253]
Paulson <i>et al.</i>	2,123,434 [R. 256]
Jaffa	2,442,272 [R. 260]
Brady	2,458,333 [R. 265]

In so allowing the Whitcomb application and issuing the patent in suit, the Patent Office did not cite and did not consider certain other prior patents [R. 45] which the District Court held [R. 149] to be “the most pertinent prior art”:

Butterworth	2,018,757 [R. 285]
Butterworth	2,045,752 [R. 281]
Land	1,666,015 [R. 292]
Jensen	1,730,658 [R. 288]
Olsson	2,065,462 [R. 278]
Robinson	1,701,824 [R. 298]
Court	2,245,554 [R. 272]

Since Appellee, in order to continue in its business without interference from Appellant, found it necessary to secure a judicial declaration that Appellant’s patent was invalid, Appellee brought [R. 3] this action for Declaratory Relief, seeking a judicial declaration of invalidity of the patent in suit.

Since the question of validity in this case is a matter of law, the patent in suit and the prior art speaking for themselves, and no genuine issues of material fact being involved, Appellee sought to expedite matters and avoid a useless trial, by bringing a Motion for Summary Judgment [R. 42]. The lower court, after full consideration of all of the evidence submitted and arguments of counsel, granted [R. 130-145] Appellee’s Motion for Summary Judgment [R. 42], and entered an appropriate Final Judgment [R. 145] in accordance therewith.

## SUMMARY OF ARGUMENT.

### I.

**WHITCOMB PATENT IN SUIT IS INVALID FOR CLAIMING OBVIOUS METHOD, BECAUSE ANTICIPATED BY PRIOR ART, AND BECAUSE LACKING INVENTION OVER THE PRIOR ART.**

A patent that claims a method which is no more than the obvious method of securing the desired result, or which was already clearly described in prior patents issued more than a year before the filing of the application, or which fails to define invention over the prior art, is clearly invalid.

**A. Patent in Suit Discloses and Claims a Method Which Is Obvious and Anticipated by Analogous Prior Patents.**

(1) Whitcomb Patent in Suit Describes and Claims a Simple and Obvious Process Which Is Obviously Old and Unpatentable.

The patent in suit claims a method which consists in substance in spraying a solvent solution against the tank walls, draining the sprayed solvent out of the tank by gravity, screening the drained solvent to separate from it any coating particles removed thereby, and recirculating the screened solvent back to the sprays. Some of the claims specify additionally a final water rinsing step, with or without an emulsifying agent. Such a method has, of course, been used for many years for just such a purpose.

(2) Examiner Allowed Whitcomb Application Because He Did Not Have the Most Pertinent Prior Art Before Him.

A comparison of the prior art relied upon by Appellee with that cited by the Examiner shows that the Examiner did not consider the most pertinent prior art. The readily



observable differences clearly suggest that had the Examiner considered this more pertinent prior art, he would never have issued the Whitcomb patent.

**(3) Every Element of Every Claim Is Found in Analogous Prior Patents Not Cited by the Examiner.**

A side by side comparison of the patent in suit with Butterworth 2,018,757 establishes that the patent in suit is anticipated (or substantially so) by the Butterworth patent. Additional disclosure of many of the claimed features of the patent in suit is to be found in the prior patents to Land 1,666,015, Olsson 2,165,462 and Foster 1,141,243.

**B. Being Anticipated by the Prior Art, the Whitcomb Patent in Suit Is Necessarily Void for Want of Invention.**

Because the Court below found the patent in suit invalid for anticipation or *other* want of invention, Appellant would have this Court of Appeals believe that there is a weakness in the position taken by the Court below as regards anticipation. The fact is that the Court below held the patent in suit invalid and void for want of invention over the prior art [R. 153, 4th Conclusion of Law]. The lesser is included within the greater; anticipation is but one type of want of invention.

**C. Invalidity for Want of Invention Is Obvious on the Face of the Patent in Suit When Viewed in the Light of the Prior Art.**

The patent in suit is obviously invalid for claiming a method which is nothing more than the obvious method of accomplishing the desired result, for claiming only that which is clearly taught in the prior art, and because the method claimed is no more than a mere aggregation of steps long known and employed in the fuel tank cleaning art.

II.

**INVALIDITY OF THE PATENT IN SUIT MAY BE DETERMINED ON MOTION FOR SUMMARY JUDGMENT BECAUSE PATENT IN SUIT AND THE PRIOR ART IN EVIDENCE ARE SIMPLE AND REQUIRE NO EXPLANATION AND THERE ARE NO QUESTIONS CONCERNING THEIR ADMISSION INTO EVIDENCE—VALIDITY PRESENTS A PURE QUESTION OF LAW.**

Rule 56 of the Federal Rules of Civil Procedure provides the mechanism for summarily entering judgment on motion where the controlling facts are uncontroverted and the decision of the case is reduced to a pure question of law.

**A. Admissibility of Evidence Not Questioned—All Was Properly Before Court Below.**

The trial court's judgment of invalidity of the patent in suit was based solely upon documentary evidence: the patent in suit, the Patent Office file wrapper and contents, the prior patents cited by the Patent Office, and certain prior patents which were not cited nor considered by the Patent Office. The admissibility of this evidence is unchallenged.

**B. The Evidence Upon Which the Decision in This Case Is Predicated Is Easily Understood—Extrinsic Evidence Is Not Required to Explain or Evaluate the Prior Art and Its Applicability to the Subject Matter of the Patent in Suit.**

The controlling facts in this case are established by unchallenged documentary evidence; the documents are in the English language, they are not technical in nature or subject matter, and they relate to an extremely simple and well known process.

**C. Absurd Contentions Concerning Inferences to Be Drawn From the Evidence Do Not Create Issues of Fact Which Are Either Genuine or Material.**

The evidence in this case is unchallenged and uncontroverted and establishes the facts upon which the Court's decision is and must be based. The inferences or conclusions which could or should be drawn from these facts, particularly when considered in the light of the applicable law, are the judicial function; one does not raise a genuine issue of material fact by taking the opposite view as regards such inferences and conclusions—this is a matter for argument.

**D. There Is No Issue of Fact, Genuine or Otherwise as to the Contents of the Patent in Suit, the Contents of the File Wrapper Record, or the Contents of the Various Prior Art Patents.**

The documentary evidence is self-contained and speaks for itself; there can be no question as to the contents of such documents, and the admissibility of such evidence has never been challenged.

**E. No Weight or Consideration Should Be Given to Appellant's Arguments on Matters Not Material to the Questions Raised by This Appeal.**

This Court of Appeals can and should cut through all of the superficialities and go directly to the heart of the matter by making a simple, side by side comparison of the patent in suit with the prior art patents. When this is done, no amount of extraneous argument can conceal the obvious invalidity of the patent in suit.

**F. Where the Entire Case Is Disposed of by a Decision on One Ground Which Is by Its Nature Dispositive of the Case, Factual Issues Involved in Other Grounds Are Not Material.**

Having decided a pure question of law on uncontroverted facts which disposes of the litigation, the Court below was not required to go into any of the other questions which were, or might have been, raised in connection with other grounds or theories upon which a decision could be based. The situation here is not to be confused with the case where the trial court is required to decide the question of validity even where it finds non-infringement—this is required in order to protect the public against the threat of litigation based on an invalid patent. Here the patent has been held invalid.

**G. Opinion Evidence by Expert Witness Which Is Not Needed to Explain the Patent or the Prior Art Must Be Taken for What It Is—Argument of Counsel.**

The evidence in this case is simple and readily understood and expert testimony is not required. Under such conditions, testimony of an expert witness is no more than the familiar and deplorable practice of arguing the case from the witness stand; in this case, the sin is aggravated because it is done by way of an affidavit. Such arguments cannot create an issue of fact any more than any other argument presented by counsel.

III.

**THE PATENT IN SUIT IS INVALID AND THE  
JUDGMENT SO HOLDING SHOULD BE  
AFFIRMED.**

The patent in suit is obviously invalid. The court below held correctly that there was no genuine issue as to any material fact necessary to the consideration and determination of the invalidity of the patent in suit. Where, as here, it appears from the state of the art as shown to exist by the prior patents, and upon a comparison of the older processes with the method described in the patent in suit, that the patent claims are not novel, or that the claimed invention is anticipated by the prior art, it is the duty of the Court to grant summary judgment on the issue of validity. This duty being properly discharged and embodied in the Final Judgment in this cause, it is the duty of this Court of Appeals to affirm that judgment.



## ARGUMENT.

### I.

WHITCOMB PATENT IN SUIT IS INVALID FOR CLAIMING OBVIOUS METHOD, BECAUSE ANTICIPATED BY PRIOR ART, AND BECAUSE LACKING INVENTION OVER PRIOR ART.

A patent that claims a method which is no more than the obvious method of securing the desired result is invalid (35 U. S. C. 103; *Dow Chemical Co. v. Halliburton Oil Well Cementing Co.*, 324 U. S. 320).

A patent which is anticipated by the prior art is invalid—claims which define nothing more than what was already clearly described in prior patents issued more than a year before the filing of the application are invalid for anticipation (33 U. S. C. 102; *Mattler v. Peabody Engineering Corp.*, 77 F. 2d 56; *Muench-Kreuzer Candle Co., Inc. v. Wilson*, 246 F. 2d 624).

Patent claims which fail to define invention over the prior art are invalid for want of invention—unless the claims define differences such that the subject matter as a whole would not have been obvious to one skilled in the art at the time the invention was made, the claims are invalid for want of invention (35 U. S. C. 103; *Stauffer v. Slenderella Systems of California, Inc.*, 115 U. S. P. Q. 347).

Application of the above stated principles to the undisputed facts of the case at bar leads to a single conclusion: the patent in suit and each and every claim thereof is invalid and void.

**A. Patent in Suit Discloses and Claims a Method Which Is Obvious and Anticipated by Analogous Prior Patents.**

While it is believed perfectly obvious from a mere inspection of the patent in suit [R. 226] and a comparison thereof with the prior art relied upon by Appellees [R. 272-303] on their Motion for Summary Judgment, that the patent in suit is invalid, Appellee, in order that there be no misunderstanding about its position in this matter, devotes the next three sub-topics to such a comparison.

**(1) Whitcomb Patent in Suit Describes and Claims a Simple and Obvious Process Which Is Obviously Old and Unpatentable.**

The Whitcomb *et al.* patent in suit relates to a method of cleaning tanks, its stated object being to clean or remove from aircraft fuel tanks the coatings of sealing materials which are applied to the tank joints to prevent leakage.

The method described by the patent [R. 226] consists in spraying a solvent solution against the tank walls (no particular solvent being specified), draining the sprayed solvent out of the tank by gravity (along with any coating particles which it removes), screening the drained solvent to separate from it any coating particles, and then recirculating the screened solvent to the sprays. The patent also mentions that after the solvent cleaning is completed, it may be desirable to spray the tank with a soapy solution (the patent referring to this as a "water-rinsable, emulsifying spray"), and then to rinse the tank with water.

It must be apparent at this point that the Whitcomb method is not startlingly new and does not produce any really unexpected results. The claims, however, are unexpectedly broad and are clearly an attempt to cover per-

fectly obvious ways of cleaning tanks, as may be seen from the following side-by-side comparison of Claim 5 of the patent in suit with one obvious way of accomplishing the same result.

*Claim 5.*

5. The method of removing the sealant from within an aircraft integral fuel-tank, which comprises

impinging a spray of solvent, against the sealant to remove same,

washing free sealant from the tank by free solvent,

screening out sealant from the solvent,

recirculating the latter as a spray against remaining sealant,

and, when the sealant is substantially removed, applying rinse water to remove solvent and loosened sealant remaining in the tank.

*A "Hand" Process.*

To "hand" clean a tank having a bottom drain, we place a milk bucket with a screened top below the drain, then:

using a "Flit" gun, we spray solvent against the inner upper walls of the tank,

we continue spraying to cause solvent to run down the walls and out the bottom drain,

solvent passes through the screen and into the bucket, thus "screening out" any pieces of coating that may have been dislodged,

when our "Flit" gun is empty, we refill it from the bucket and go on with our spraying,

then, at the stated time, we turn the garden hose into the tank to rinse down the cleaned walls and flush everything out the drain.

Claim 1 is similar to Claim 5 but additionally specifies that the tank should be sealed while the method is being carried out and specifies that after the solvent cleaning is completed and before the water rinse is applied, the tank should be sprayed with a soapy solution.

Claim 2 is the same as Claim 1 except that it does not specify sealing the tank while the method is carried out.

Claim 3 is in essence the same as Claim 2 except it specifies preferred pressures for spraying the solvent and water rinse, and states that the temperature of the solvent should be from 60° F. to 120° F. However, the patent specification does not teach that there is anything critical or significant in those particular pressures or temperatures.

Claim 4 is substantially like Claim 5 except that it specifies that the tank being cleaned has bulkheads against which the solvent is sprayed.

Claim 6 is in essence like Claim 5 except that it states that the water rinse is applied at a pressure higher than the pressure of the solvent spray.

Claim 7 is like Claim 6 except that it specifies that the water rinse pressure is 300 pounds per square inch.

Claim 8 is substantially like Claim 5 except that it omits the final water rinse step of Claim 5.

There is nothing new or startling in any of these features, and none of them produces any more than the obvious and expected result. The patent is invalid on its face.

**(2) Examiner Allowed Whitcomb Application Because He Did Not Have the Most Pertinent Prior Art Before Him.**

As originally filed, the application for the patent in suit sought to patent a method as well as an apparatus for cleaning tanks. The first Patent Office Action, however, required division, and the applicants cancelled the apparatus claims and retained the claims to the alleged method. The Patent Office considered and treated the alleged invention to be in the general art of tank cleaning and rejected the original claims [see Ex. B] on the Butterworth Reissue patent No. Re. 19,374 [R. 231] and the Foster patent No. 1,141,243 [R. 236].

As was indicated by the Examiner's citations, and as will be pointed out more fully hereinafter by reference to other and more pertinent prior art, tank cleaning by continuously spraying solvents onto tank walls is a very old art. It has been extensively used in the cleaning of railroad tank cars, ship tanks, large drums and automobile radiators. Such new developments as there have been during the past twenty to thirty years have been by way of improvements in the apparatus used for such cleaning methods. Different cleaning problems require different solvents, and in some cases, require new apparatus adapted particularly to the structure to be cleaned, but the method utilized is the same in practically all cases. This was recognized by the Examiner when he cited the Butterworth and Foster patents.

The Butterworth patent Re. 19,374 [R. 231], the principal prior art relied upon by the Patent Office, shows a tank cleaning system in which solvent solution is pumped from the bottom of the tank being cleaned to sprays located in the upper part of the tank, the sprayed solvent, as well as any particles of coating which it removes, draining by



gravity down the side walls of the tank to the tank bottom from which the solution is picked up by the pump and recirculated after being passed through a settling tank. The Foster patent No. 1,141,243 [R. 236] shows that it was old to use soapy solutions and water rinses for cleaning all kinds of surfaces.

When confronted with the above-mentioned rejection of the original claims on Butterworth and Foster, the applicants for the patent in suit then cancelled the original claims, and inserted claims calling for the sprayed solvent solution to be drained by gravity from the tank and screened before being recirculated—they argued that their method differed from Butterworth Re. 19,374, and Foster 1,141,243 in that the pump of the Butterworth patent would become clogged if the solvent were recirculated from the tank bottom without being screened. Affidavits were submitted stressing the alleged importance of draining the solvent from the tank and screening it before recirculating it and stressing the alleged commercial success of the method. After two personal interviews between applicants' attorney and the Patent Office Examiner, the Examiner was persuaded by that argument to allow the claims of the patent [see Ex. B].

The Examiner's real reasons for allowing the Whitcomb claims must remain a matter of speculation and conjecture. This much, however, is obvious—the principal weakness in the Examiner's position was his lack of a prior art patent teaching the step of screening the solvent before it is pumped back to the sprays and teaching the idea of draining the sprayed solvent from the tank by gravity rather than pumping it out.

There is little room for doubt that if the Examiner had had before him the references upon which Appellee

presently relies, he would have found these steps to be old and well known in the prior art long before the alleged invention by Whitcomb and would have steadfastly refused to allow Whitcomb's claims.

**(3) Every Element of Every Claim Is Found in Analogous Prior Patents Not Cited by the Examiner.**

If the Patent Office Examiner had made a thorough search of the prior art as he should have done, he would have found and cited prior patents which completely anticipate the method claimed by the patent in suit—even to the draining of the sprayed solvent from the tank by gravity and screening it before recirculating it. Such anticipatory prior patents which the Examiner failed to cite and consider were relied upon by Appellee in its Motion for Summary Judgment and constituted the basis for the Summary Judgment entered by the Trial Court in this case. These patents are enumerated and identified in *Exhibit D* [R. 271-303]. A brief comment concerning the most pertinent of each of these follows:

Butterworth 2,018,757 [R. 285] in Figure 3 discloses forcing a solvent solution by a pump 29 through line 26 to sprays 30 in the tank 31 being cleaned. The solvent is sprayed onto the walls of the tank and, along with any removed coating, drains by gravity to the bottom of the tank and drains by gravity out through the outlet 33 and drains by gravity into the catch basin 35. This solvent passes through screen 38 and line 36 to the supply tank 24 from which it is recirculated by the pump 29. This patent refers to the screen 38 as a "weir," the purpose of the weir being stated in the patent as "to prevent the passage of scale or other solid material into line 26." [R. 286, right col., line 32.]

Appellant seeks to draw a vitalizing distinction between “weir” and “screen,” stating that a weir is in the nature of a dam and material flows over the top of a weir and not through it. This is not the way it appears in Butterworth’s Figure 2 and is contrary to the Butterworth specification.

The purpose of the weir, screen, settling basin, trap or whatever one chooses to call the instrumentality in question, is to hold back any scale or other solid material that might otherwise be drawn into the pump. If it is of any importance at all, the method step in question is that of separating out the solid material from the liquid. This is clearly taught by Butterworth 2,018,757. See also, Butterworth 2,045,752 [R. 281], page 2 [R. 283], lines 17 *et seq.* Also note the screen shown in the drawings of Jenson 1,730,658 [R. 288]. Note also the screen 31 of Court 2,245,554 [R. 272], the screen 24a of Robinson 1,701,824 [R. 298]—and note particularly that no screening means of any kind whatsoever is specified by any of Claims 1, 2, or 3 of the patent in suit.

Land 1,666,015 [R. 292] teaches the recirculation of solvent in a closed system with the tank sealed, and teaches the use of a final water rinse.

Olsson 2,065,462 [R. 278] teaches the spraying of a cleaning solvent against the bulkheads of a tank (see Claim 4 of the patent in suit), the spray draining down the bulkheads by gravity.

As before stated, the Foster patent 1,141,243 [R. 236] cited by the Examiner, shows that it is old to use soapy solutions and water rinses in connection with the cleaning of all kinds of surfaces. Appellant argues that the claims do not call for the use of a soapy solution. This is a

mere quibble on words. Foster, in teaching the use of a soapy solution, necessarily teaches the use of a water-rinsable emulsifying solution (see Claim 1 of the Whitcomb patent in suit). Obviously, a substance claimed in generic terms (Water-rinsable emulsifying solution) is anticipated by the disclosure of a specie of such material (soapy solution).

From the foregoing it is apparent that the above discussed prior art, all of which (with the exception of the Foster patent showing that it is old to use soap to clean things) was not cited or considered by the Patent Office, anticipates everything that the patentees of the patent in suit urged as being novel in order to obtain allowance of the patent claims. The Court below reached the only tenable conclusion when it found the patent in suit to be invalid because anticipated by the prior art [R. 140].

**B. Being Anticipated by the Prior Art, the Whitcomb Patent in Suit Is Necessarily Void for Want of Invention.**

The term "anticipation" has two meanings as applied to inventions and patentability: the first and most common meaning is that anticipation of a claim is found when the claim does not set forth anything that is not found in the prior art; the second meaning is a strict technical usage which finds anticipation when every element and feature of the claim is found in a single prior art reference but not when reliance must be had on a second reference for one or more of the claimed elements or features. In this latter case, the claim is invalid for "want of invention" if the subject matter as a whole would have been obvious to one skilled in the art at the time the invention was made (35 U. S. C. 103; *Stauffer v. Slenderella Systems of California, Inc.*, 115 U. S. P. Q. 347).



The Trial Court, thinking first in terms of the common and ordinary meaning of the word "anticipation," held the patent in suit invalid because anticipated by the prior art [R. 140]. Then, recognizing that one might base an argument upon the difference between the technical and ordinary meanings of the term, the Trial Court went on to say "Even if it be said that there appears no 'strict anticipation' of the patent in suit, and that the method involves some novelty, it nonetheless lacks invention." [R. 140.]

Appellant seeks to make capital of the quoted statement by urging to this Court of Appeals that the Trial Court was aware of an inherent weakness in its holding of anticipation. Unfortunately, such an argument only imposes upon Appellee the burden of answering it and imposes upon the Court of Appeals the double burden of considering both arguments.

The fact is that a patent invalid for want of invention is just as invalid as a patent which is anticipated. What difference does it make whether all of elements and features of the claim are found in a single prior patent or in a group of prior patents, if (as stated in 35 U. S. C. 103) the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains? As Judge Fee stated for this Court of Appeals in *Stauffer v. Slenderella Systems of California, Inc.*, 115 U. S. P. Q. 347:

"the advances in the prior art may be such that although there is no strict anticipation . . . a trained mechanic would if presented with the problem solve it without difficulty."



See also *Bergman v. Aluminum Lock Shingle Corp. of America*, 116 U. S. P. Q. 32, decided by this Court in December 1957.

**C. Invalidity for Want of Invention Is Obvious on the Face of the Patent in Suit When Viewed in the Light of the Prior Art.**

Appellant argues that the prior art relied upon by the Court below to support its judgment of invalidity is not analogous. Appellant's attempts to generate a distinction where none exists by calling a method of cleaning tanks a method of rebuilding tanks is so patently a clutching at straws as to require no answer. We would not presume to state it any more clearly than did the Court below:

"Clearly, no fact finder could reasonably conclude that patentable novelty subsists in the discovery that an old method used in cleaning railroad tank cars, ship tanks, drums and radiators can be adapted to the cleaning of airplane fuel tanks." [R. 142.]

Appellant also seeks to avoid the Trial Court's holding of aggregation by asserting to this Court that here the whole exceeds the sum of the parts. It was obvious to the Court below, as it must be to this Court of Appeals, that the concert of known steps produces no more than what is produced by the individual steps. Here again we quote the opinion of the Court below:

"The most that can be said of the patent in suit is that the method claimed to constitute invention is but a mere aggregation of steps long known and employed in the fuel tank cleaning art." [R. 142.]

## II.

**INVALIDITY OF THE PATENT IN SUIT MAY BE DETERMINED ON MOTION FOR SUMMARY JUDGMENT BECAUSE PATENT IN SUIT AND THE PRIOR ART IN EVIDENCE ARE SIMPLE AND REQUIRE NO EXPLANATION AND THERE ARE NO QUESTIONS CONCERNING THEIR ADMISSION INTO EVIDENCE—VALIDITY PRESENTS A PURE QUESTION OF LAW.**

It is an elementary and fundamental proposition that in the peculiar case where the controlling facts are uncontroverted and the decision of the case is reduced to a pure question of law, judgment may be entered summarily upon proper motion (F. R. C. P. 56(c)).

### **A. Admissibility of Evidence Not Questioned—All Was Properly Before Court Below.**

The evidence before the Court below was the patent in suit No. 2,653,116 [R. 226], a certified copy of the file wrapper and contents of the patent in suit [Ex. B], the prior patents cited by the Patent Office against the application for the patent in suit [R. 230-270], the heretofore listed prior patents which were not cited nor considered by the Patent Office [R. 271-303], and certain other documentary evidence (not here important because it did not furnish a basis for the decision of the Lower Court).

All of this evidence was introduced in connection with Appellee's Motion for Summary Judgment by means of an affidavit of Appellee's counsel, Walter P. Huntley, which affidavit is completely free of statements of opinion or argumentative matter and serves only to identify and authenticate the accompanying exhibits which constituted

the evidence hereinbefore designated. (See F. R. C. P. 56 *re*: evidence introduced by affidavits.)

Nowhere has Appellant challenged the right of the Court below or this Court to consider all of said evidence for all purposes, nor has Appellant attempted in any way to controvert the affidavit by which it was introduced.

**B. The Evidence Upon Which the Decision in This Case Is Predicated Is Easily Understood—Extrinsic Evidence Is Not Required to Explain or Evaluate the Prior Art and Its Applicability to the Subject Matter of the Patent in Suit.**

The conclusion stated in this topic heading will be obvious to this Court of Appeals from a mere inspection of the documentary evidence in the record. While Appellant challenges this statement, it is significant that Appellant does not anywhere designate or point out with any degree of particularity what parts of the evidence are so abstruse as to require extrinsic evidence for their explanation.

The truth of the matter is that the patent in suit, the prior art patents, and the file wrapper and contents of the patent in suit, are ordinary English language documents which are not technical in nature or subject matter and which relate to an extremely simple and well known process and an equally simple apparatus for carrying out the steps of that simple process. In such cases, Summary Judgment is proper [see cases cited by Trial Court at R. 137].

**C. Absurd Contentions Concerning Inferences to Be Drawn From the Evidence Do Not Create Issues of Fact Which Are Either Genuine or Material.**

Appellant seeks to raise a critical and controlling issue of fact by a lengthy, abstruse and almost incomprehensible discourse upon the alleged differences between a weir and

a screen. Such an argument tends to obscure the real issue—the question is whether the prior art teaches the essential method step claimed, and that method step is removing the solid parts of the removed sealant from the solvent before the solvent is pumped back to the spray heads. Since the patent is a method patent and deals with procedural steps, it matters not whether removal of such solid material is effected by a weir or a screen. Insofar as the patent in suit and the prior art are concerned, a weir and a screen are equivalents—they constitute substantially the same instrumentalities operating in substantially the same way to accomplish substantially the same result, *i.e.*, straining out the chunks of material dislodged by the sprays (*Celite Corp. v. Decalite Co.*, 96 F. 2d 242, 248).

Appellant also seeks to draw distinctions among “soap,” “soapy,” “emulsifier” and “a water-rinsable, solvent-miscible, emulsifying material.” The Court of Appeals will have no difficulty in ascertaining that whether one uses such simple and homely words as “soap” or “soapy” or seeks to hide behind abstruse language such as above quoted, the meaning is the same. All the patent calls for is something that has long been used in this particular art, *i. e.*, an emulsifying material which permits a water spray readily to rinse away loosened and emulsifiable materials adhering to the walls of the tank.

Appellant would have the Court believe that there is some great, vast and mysterious difference between aircraft fuel tanks and other kinds of tanks. This is predicated primarily upon the romance and glamor that is ordinarily associated with the flying of aircraft, particularly military aircraft, and the impressively large amounts of money that are involved in the military air operations. However, as soon as we get the stardust out of our eyes,



we can see that washing the inside of a tank by means of a spray is about the same sort of thing whether it is done inside an airplane wing tank or inside a railway tank car.

**D. There Is No Issue of Fact, Genuine or Otherwise, as to the Contents of the Patent in Suit, the Contents of the File Wrapper Record, or the Contents of Various Prior Art Patents.**

The Court of Appeals will at this point notice that Appellant has no quarrel actually with the evidence that was before the Court below and brought before this Court on this appeal; what Appellant quarrels with are the inferences which necessarily follow from that evidence. This Court will also realize that Appellant cannot conjure up a genuine issue of material fact by quarreling with the inference or the conclusion of law.

As this Court said in *Bergman v. Aluminum Lock Shingle Corp. of America*, 116 U. S. P. Q. 32:

“The nature of the prior art and the nature of what the patentee did to improve upon it must always be questions of fact. The question of the name to be given to what was done by the patentee, whether it is to be called an invention over the prior art or whether it is not, [is] a question fundamentally of the meaning of the words used in the statute, and as such would seem to be a question of law.”

**E. No Weight or Consideration Should Be Given to Appellant's Arguments on Matters Not Material to the Questions Raised by This Appeal.**

Appellant cites more than thirty alleged errors; only about a dozen of these relate directly to the Findings of Fact accompanying the Judgment in this cause. Yet none of these challenged findings has been directly attacked by Appellant in its brief. Instead, Appellant seeks to cast



doubt upon a legal conclusion which necessarily follows from the undisputed facts, and on that basis urges that there is a disputed question of fact.

The truth of the matter is that there are no facts in dispute, and the Court of Appeals may readily ascertain that the Court below drew the correct inferences and arrived at the correct conclusions merely by placing the patent in suit and the prior art patents side by side.

**F. Where the Entire Case Is Disposed of by a Decision on One Ground Which Is by Its Nature Dispositive of the Case, Factual Issues Involved in Other Grounds Are Not Material.**

The court below found the patent in suit to be invalid for want of invention because of anticipation by the prior art. There can surely be no quarrel with the holding that a patent is invalid if it lacks invention and if it is anticipated by the prior art. This disposes of the case in its entirety and it is immaterial that Appellee urged to the Court below other reasons for granting the Judgment sought.

As this Court will have noted from the record, Appellee presented to the Court below evidence relating to other prior publications, as well as evidence relating to prior invention by another and prior public use. The lower Court, finding the patent to be invalid over the patented prior art, quite properly held that all other issues of fact became as a matter of law immaterial [R. 144-145 and cases there cited]. It would be a futile act to consider such other issues because, regardless of how such issues might be

decided, the ultimate judgment would remain unchanged—the patent in suit is invalid because it does not involve invention over the prior art as represented by the unchallenged and uncontroverted prior patents which were presented to the Court below and are by this appeal presented to this Court of Appeals.

**G. Opinion Evidence by Expert Witness Which Is Not Needed to Explain the Patent or the Prior Art Must Be Taken for What It Is—Argument of Counsel.**

Advocacy on the record through the affidavit of a patent lawyer employed by Appellant as an expert witness cannot create an issue of fact where none exists. Alleged “expert opinion” where none is needed, and amounting to no more than an argument of the case, cannot change the facts and must be ignored. A few quotations from the affidavit of William Douglas Sellers [R. 98-111] (upon which Appellant relies heavily to demonstrate the postulated existence of an issue of fact) will be sufficient to illustrate the point:

“No second and different spray to wash out an initial spray material is even remotely hinted at in Butterworth.”

“In short, Butterworth falls far short of showing the different elements of Claim 3 of the patent in suit, as stated.”

“As a matter of fact the draftsman simply was not careful and he forgot to leave the top of the pipe 5 open.”

“Butterworth is directed to removing a residual oil film and not to the problem of separating from a tank

a sealant that is essentially an integral part of the tank in normal operation, and without which sealant the tank is inoperative for fuel storage.”

“Turning an airplane upsidedown is rather impractical, and in any event, aircraft sealant could not be removed without any spray, merely by a reverse flow.”

“An expert in the field of aircraft fuel tanks could not be expected to know about coking chambers.”

“This is a far cry from a method of rebuilding the sealed fuel tanks of aircraft by removing an integral lining, a task previously so difficult that men actually climbed inside and did the work by hand.”

It is clear from the foregoing that there is here no genuine issue of material fact necessary to deciding the question of law involved, *i. e.*, validity of the patent in suit. (*Bergman v. Aluminum Lock Shingle Corp. of America*, 116 U. S. P. Q. 32.)

Despite Appellant's best efforts to the contrary, it is abundantly clear that with respect to each and every contention made by Appellant, there is no issue, or the facts involved are not material, or the alleged issue is not “genuine.”

Appellant's contention that the judgment should be reversed because a trial is needed to ascertain the essential facts is clearly erroneous. The Judgment should be affirmed.

III.

THE PATENT IN SUIT IS INVALID AND THE  
JUDGMENT SO HOLDING SHOULD BE  
AFFIRMED.

As is pointed out above, the patent in suit is invalid for anticipation and want of invention. As the trial Court said:

“Here, it appears as a matter of law from undisputed facts disclosed by the letters and the file wrapper of patent 2,653,116, and the prior-art patents, both cited and non-cited, that the patent in suit is invalid because of ‘strict anticipation’ [35 U. S. C. §102(b)] or, in any event, for want of patentable novelty. [Id. §103.]” [R. 144.]

The judgment below [R. 153] so holding the patent in suit invalid is obviously correct and should be affirmed.

The granting of a Motion for Summary Judgment in this case was proper for the reasons hereinbefore explained. As the Trial Court said (paraphrasing the language of *Market Street Cable Railway v. Rowley*, 155 U. S. at 625):

“If, upon the state of the art as shown to exist by the prior patents, and upon a comparison of the older processes with the method described in the patent in suit, it should appear that the patent claims are not novel, or that the claimed invention is anticipated by the prior art, it becomes the duty of the court to grant summary judgment upon the issue of validity” [R. 143].

The Trial Court correctly held that there was no issue of fact, genuine or otherwise, as to the contents of the patent in suit, the contents of the file wrapper record of the Pat-

ent Office proceedings leading to the issuance of the patent in suit or the contents of the various prior art patents [R. 130, 146]. The Trial Court also correctly found that there could be no issue of fact, genuine or otherwise, that the enumerated patents (those not cited by the Examiner, but relied on by Appellee) were not cited or considered by the Patent Office in connection with the application for the patent in suit [R. 136]. The Trial Court also correctly found that in the fuel tank cleaning art and analogous arts, the essential steps of the method or process are easily understood from a reading of the claims of the patent in conjunction with the specification and drawings [R. 136]. The Trial Court also found correctly that extrinsic evidence is not needed to explain or evaluate the prior art and its applicability to the subject matter of the patent in suit [R. 151].

In this case, as this Court clearly explains in *Bergman v. Aluminum Lock Shingle Corp. of America*, 116 U. S. P. Q. 32, the question of validity is a question of law and the Court below correctly and properly decided that issue in granting Summary Judgment (F. R. C. P. 56).

It is suggested that Appellant is not entitled to any sympathy on its alleged loss of an opportunity to try this patent case to a jury. Appellant would have this Court believe that it had been "short circuited" out of a jury trial to which it was entitled as a matter of right. This is simply not so. In this case the Summary Judgment procedure has served its intended purpose; *i. e.*, that of disposing of litigation summarily and avoiding the cost and



burden of a full-fledged trial where the case boils down to a pure question of law without any genuine issues of material fact.

The fact of the matter is that the Trial Court placed the patent in suit and the prior art side by side and saw immediately and clearly that the patent was invalid—this Court of Appeals can, and should do the same thing.

For the reasons stated it is respectfully submitted that the judgment below should be affirmed.

Respectfully submitted,

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and

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No. 15,893

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

CEE-BEE CHEMICAL Co., INC., a corporation,

*Appellant,*

*vs.*

DELCO CHEMICALS, INC., a corporation,

*Appellee.*

---

## BRIEF OF APPELLANT IN RESPONSE TO APPELLEE'S BRIEF.

---

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FILED

AUG 11 1958

PAUL P. O'BRIEN, CLERK



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### BRIEF OF APPELLANT IN RESPONSE TO APPELLEE'S BRIEF.

---

Comes now the above-named appellant and in response to appellee's brief, states as follows:

#### Appellee Reversed Questions on Appeal.

It is believed that the appellee in its brief should have reversed the two questions which it submits on appeal. It puts the question of validity first, and the question of whether there is a genuine issue of material facts second (pp. 3-4). It is submitted that the first, and the appellant believes the only question to be considered by this Honorable Court is whether there is at least one genuine issue of material fact which precluded the lower court from granting the appellee's Motion for Summary Judgment. This is not an appeal from a judgment after a trial on the merits of the case. If this Honorable Court holds

that there is at least one genuine issue of material fact, then a reversal of the lower court would seem to be in order, and the second question, to wit, *re* the validity of the patent in suit, is not to be considered at this time.

### **Appellee's Brief Divided Into Two Parts.**

Appellee's brief filed herein appears to have been written by two different persons. The first twelve pages are devoted to sweeping generalities which are rather unrealistic, ignoring facts where it seems convenient to do so, and failing to point out specifically the bases for the pages of legal conclusions. The last twenty-one pages appear to be more specific to the present case. The appellant will endeavor to point out discrepancies in both the general and the specific parts of appellee's brief.

### **Appellee Argues There Are No Genuine Issues of Material Fact.**

The appellee "represents" that there is "no genuine issue as to any material fact necessary to the consideration and determination of the question of the validity" of the patent in suit (pp. 4 and 12), "no genuine issues of material fact being involved" (p. 6), "controlling facts are uncontroverted" (p. 9), "controlling facts in this case are . . . unchallenged" (p. 9), "the evidence . . . is unchallenged and uncontroverted" (p. 10), "uncontroverted facts" (p. 11), the claims "define nothing more than what was already clearly described in prior patents" (p. 13), "the controlling facts are uncontroverted" (p. 24), "Appellant has no quarrel actually with

the evidence" (p. 27), "undisputed facts" (p. 28), "no facts in dispute" (p. 28), "there is here no genuine issue of material fact necessary to deciding the question of law involved, i. e., validity of the patent in suit" (p. 30), "there is no issue, or the facts involved are not material, or the alleged issue is not 'genuine' " (p. 30), "no issue of fact, genuine or otherwise, as to . . . the contents of the various prior art patents" (pp. 31-32), and, on the very last page of the brief, "the case boils down to a pure question of law without any genuine issues of material fact" (p. 33).

The contention of appellee that there is no genuine issue of material fact is probably the most frequently reiterated phrase in the appellee's entire brief. Because of such repetition, appellee must feel that this question is of prime importance, and that if the Appellant can show even one genuine issue of material fact, then the judgment of the lower court should be reversed. It is believed that it can be shown from appellee's own brief that there is more than one genuine issue of material fact in this case, as will now be considered.

#### MATERIAL ISSUE NO. 1:

##### Does the Patent in Suit Cover a "Soapy" Solution?

The appellant in its original brief in this case pointed out that the second step of claims 2 and 3 of the patent in suit covers the applying of "a substantially less volatile, water-rinsable, solvent-miscible spray to the solvent on the sealant." This is not denied by appellee, but appellee

in its brief argues that the soap of the prior Foster patent is the same thing. The following are the diametrically opposite contentions of the parties as to this second step:

*Appellant's Contentions.*

1. This "solvent-miscible" material is not a "soapy" solution.

2. A soapy solution would wash away the solvent and leave the sealant as it originally was—unremoved.

3. The use in the second step, of a soapy solution, would defeat the patented process, render it inoperative, and produce just the opposite results from those desired [Tr. pp. 96-97].

4. The use of the soapy solution of the prior patent to Foster, No. 1,141,243. would render the patent in suit inoperative.

*Appellee's Contentions.*

1. This "solvent-miscible" material is a "soapy" solution.

2. The patent in suit uses a soapy solution.

3. The second step of the patent in suit covers a soapy solution and a soapy solution does not render the patented process inoperative.

4. The use of the soapy solution of said Foster patent is the same as the second step of the patent in suit.

The importance of this point to appellee may be seen by the fact that it repeats "soap" or "soapy" approximately eleven times in its thirty-three page brief.



The following are the opposed positions taken by the parties on this issue of fact:

*Appellant's Evidence.*

1. "Soap of a soapy solution is not solvent-miscible . . . and would wash away the solvent and definitely cause the sealant to re-set as a hardened rubber compound, so soap or a soapy solution would be inoperative and produce just the opposite results from those desired."—Whitcomb affidavit [Tr. pp. 96-97]. "None of the prior patents" teaches the use of an emulsifier that is "'solvent-miscible.'"—Seller's affidavit [Tr. p. 107].

2. The second step found in the claims (*e. g.*, claims 2 and 3) "is not found in any of the prior art." (Appellant's Br. p. 19.)

*Appellee's Position.*

1. "The meaning is the same" whether it is "soap", "soapy" or "solvent-miscible" (Appellee's Br. p. 26).

2. "Every Element of Every Claim is Found in Analogous Prior Patents Not Cited by the Examiner" (heading in Appellee's Br. p. 19).

This is not "a mere quibble on words," as stated by appellee (p. 21), for if appellant's testimony and contentions are correct, the second step of the patented process is novel, produces an entirely new result over anything in

the prior art, and the question of its novelty is an issue of a material fact that should never have been decided on a Motion for Summary Judgment.

This appears to be a genuine issue of material fact that should not have been decided by the lower court on a Motion for Summary Judgment. The lower court is believed to have erred in its Conclusion of Law No. 3 [Tr. pp. 152-153] when it said that there is “no substantial dispute of fact as to . . . the prior art patents . . . and extrinsic evidence not being required for the purposes of explanation.” Both of these statements seem to be wrong, for there is the sharp dispute mentioned above concerning the prior Foster patent, to wit, whether it covers use of a “solvent-miscible” material. This is a material issue, because if the appellant’s contention is correct, then no prior patent shows the use of a “solvent-miscible” rinse (second step) between the applying of the solvent and the final wash water. The lower court is thought to have committed reversible error by stating there was “no substantial dispute” on this issue of fact.

#### MATERIAL ISSUE NO. 2:

**Are a “Weir” and a “Screen” the Same for the Present Purposes?**

Another genuine issue of material fact raised by appellee’s brief is whether a “weir” is the same thing as a “screen.” The appellee admittedly did not understand the differences between a weir and a screen, as pointed out in appellant’s original brief. The appellee terms same

“almost incomprehensible” (p. 25). The contentions of the parties side-by-side would apparently look like this:

*Appellant's Contentions.*

1. In Butterworth 2,018,757, Figs. 2 and 3 (these are different views of the same thing) show, and the specification describes, a dam 38 and a settling basin 35 behind the dam 38. Material only flows over the dam permitting “scale or other solid material” to sink to the bottom in the basin 35 behind the dam so it will not spill over into the line 36. This dam 38 is called a “weir.” — Seller’s affidavit, pp. 103-104.

2. A weir will not operate, nor accomplish the same result, as a screen in either the patent in suit or in appellee’s accused structure, because (a) the loosened, sponge-like sealant is almost the same specific gravity as the liquid solvent and practically floats, and (b) this sealant, by reason of the rapid flow of the solvent, would be washed over the top of the weir or dam with the liquid solvent [Tr. pp. 94-95].

*Appellee's Contentions.*

1. In Fig. 2 of Butterworth 2,018,757, the weir is not in the nature of a dam and material does not flow over the top of the weir. Appellant’s contention is “contrary” to this Butterworth specification (Appellee’s Br. p. 20). The solvent passes “through” the weir (p. 19, *supra*).

2. “A weir and a screen are equivalents—they constitute substantially the same instrumentalities operating in substantially the same way to accomplish substantially the same result, *i. e.*, straining out the chunks of material dislodged by the sprays.” (Appellee’s Br. p. 26.)

The dictionary definition of a weir is, "A dam in a river to stop and raise the water", and "A device for determining the quantity of water flowing over it" (Webster's New International Dictionary, 2d Edition).

The more strenuously the appellee argues that Foster's soap solution is the same as a solvent-miscible material, and that the weir of the prior Butterworth patent accomplishes the same result as the patented screen, the more clearly it emerges that here we have two strenuously disputed genuine issues of material fact; that therefore, extrinsic evidence is necessary to understand these two prior patents, and that the lower court should never have "short circuited" these strong issues of fact by granting a Motion for Summary Judgment.

### MATERIAL ISSUE NO. 3:

#### Are Prior Patents Relied on by Appellee Closer Than Prior Patents Cited by the Examiner?

A third issue raised by appellee's brief is whether the prior art cited by the Examiner was as close as the prior patents not cited by him but cited by appellee in this case. This issue of fact faces up something like this:

##### *Appellant's Testimony.*

The patents not cited by Examiner and relied upon by appellee "are no more relevant or persuasive of non-invention" in the patent suit, than the "patents cited by the Examiner" [Seller's affidavit, Tr. p. 100].

##### *Appellee's Contra.*

The "Examiner allowed Whitcomb application because he did not have the most pertinent prior art before him" (heading in Appellee's Br. p. 17).

Here, again, it is believed that the lower court should not have decided a question of material fact on a Motion for Summary Judgment. Nevertheless, the District Court decided that “the patents not cited by the Examiner are decidedly more pertinent” [Tr. p. 139], and this was a vital basis for the Court’s entire decision.

#### MATERIAL ISSUE NO. 4:

##### Whether Patented Process Produces Obvious Result?

The fourth issue raised by appellee’s brief is that the method of the patent in suit produces an “obvious and expected result” (p. 16). The appellee is overlooking the testimony that “stringers” in airplane wings were never cleaned out before the patented process came into use [Tr. p. 93]. The patented process cleaned them out, so thereafter the United States Air Force required that stringers be cleaned out! The appellee is overlooking the unexpected result that fumes and fine vapors, rather than direct spray from the nozzles, reached solvent where liquid solvent would not go [Tr. p. 204]. The appellee has also overlooked that the impingement of the liquid solvent upon the interior of the tank, in the patented process, generated heat *at the point* where it was needed for further volatilization of the volatile solvent [Tr. p. 92]. This was unexpected. None of these features was obvious since they had to be discovered after the patented process was put in use.

Outstanding proof that the patented process was not “obvious to one skilled in the art at the time the invention was made” (Appellee’s Br. p. 13) is that the record in this case shows that three trained mechanics and one General of the United States Air Force were surprised when the process of the patent in suit operated success-



fully! Nothing could be clearer than that it was not obvious to one skilled in the art, and that it produced an unexpected result. In any event, here we have a genuine issue of material fact as to whether the patented process was an obvious method, which should not have been finally determined by the lower court as not producing any unexpected result [Tr. p. 152].

The following quotation from a recent case seems apt at this point:

“. . . Those who wish to take advantage of it and deprive the inventor of the fruits of his invention unite to vie with each other in pointing out how simple it all was and how little worthwhile.”

—*The Guiberson Corporation v. Equipment Engineers Inc.*, 116 U. S. P. Q. 425, 428 (C. A. 5, Feb. 25, 1958).

### Appellee's Principal Authority.

*Bergman v. Aluminum Lock Shingle*, 116 U. S. P. Q. 32 (C. A. 9), was cited four times in appellee's brief, which is more than any other case. That case, however, was not based on a Motion for Summary Judgment. A full trial was held in that case, and this Honorable Court was called upon to decide whether it was a question of fact or a question of law as to whether the extremely simple slot in a shingle constituted an invention. It is not believed that this Honorable Court intended that that case should be interpreted to mean that all questions pertaining to the validity of a patent are only questions of law, as the appellee seems to interpret this case.

Circuit Judge Pope, in his concurring opinion, brought out that this case “is not to say that the decision in a patent case may not turn upon a question of fact.”

He quoted with approval *Walker on Patents*, Deller's Edition, page 115, that, "The nature of prior art . . . must always be questions of prior art."

Circuit Judge Pope referred to earlier decisions of this Honorable Court in which the question of validity was considered a question of fact, and stated that if he thought the *Bergman* case, *supra*, was in true conflict therewith, he would "call for a hearing by the whole court sitting in banc in order to resolve that conflict."

He concluded that the question of validity in the *Bergman* case did turn on a question of law, but that the question of validity of an invention may "turn on" a question of fact. It is believed that that is a statement that can be subscribed to by every member of this Honorable Court. It is submitted that the present case is one that "turns on" several questions of fact, which are dealt with elsewhere herein and in appellant's original brief (viz., "the nature of the prior art"), and that the *Bergman* case is not authority that all disputed issues of fact as to the nature of the prior art may be decided upon a Motion for Summary Judgment.

### "Hand" Process.

A rather far-fetched bit of unreality has been injected into appellee's brief under the heading "A 'Hand' Process" (p. 15). Appellee is apparently endeavoring to get this Court of Appeals to consider some sort of evidence that was not before the lower court and is not properly part of the record before this Court.

No attempt has been made to show that this "Hand" Process ever took place, or that it was even thought of before the application for the patent in suit. Furthermore,

it is only wishful thinking and could not take place. It takes 40 hours of *continuous* circulation of solvent to loosen sealant in an integral aircraft tank (see Whitcomb Affidavit of July 7, 1953, in file wrapper). Claim 1 calls for carrying on the patented process in a “sealed” tank. How is the hypothetical user with a milk bucket and a “Flit” gun going to be sealed inside the aircraft tank for 40 hours, refill his milk bucket outside the tank every time it is empty, and yet perform 40 hours of continuous spraying within the highly toxic fumes inside the tank? How will his “Flit” gun spray opposite sides of bulkheads inside the fuel tank, as covered in claim 4? Imagine trying to de-seal a military aircraft in time of war by this totally impractical method. The war would be over before that aircraft would ever fly again.

The author of this science fiction is suggesting an impractical *batch* process for “a continuous closed-circuit process” (claim 4). If the appellee followed the milk bucket—“Flit” gun-batch-hand process which appellee’s brief describes, it would go out of this business upon its first job!

### Lower Court’s Opinion as to What Is “Dispositive”.

Of course, no one disputes that if a court has before it all the facts necessary to enable it to determine a question of invention or anticipation, and if the facts are complete and are not in dispute, it can pass upon that issue on a Motion for Summary Judgment. Here, however, not only are the facts believed to be in sharp dispute, but there are also additional facts which will be produced upon a trial that will throw considerable light upon the issues, so it is thought that the present matter cannot properly be resolved without a trial.

A number of factual issues which were presented to the lower court were side-stepped by it with the Court's statement that "a single issue . . . is dispositive of the case" [Tr. p. 144]. The appellee commented on an issue of fact with regard to documentary evidence and said that it is "not here important because it did not furnish a basis for the decision of the Lower Court" (p. 24). This situation obtains as to not one document, but to Exhibits G, H, K, L and M.

The appellee did not cite any authority to support the lower court's position that it could pick out what it decided was a dispositive basis for its decision and disregard all other matters. The appellee did not even mention that this Honorable Court has already held in *Gillespie v. Norris*, 231 F. 2d 881, 883-884 (C. A. 9, 1956) (quoted in appellant's original brief), that this course should not be followed. Suppose the lower court is in error as to what is dispositive, as he is believed to be in this case? This would lead to multiple, piecemeal appeals in a single case. That is the very criticism of this Honorable Court in the *Gillespie v. Norris* case, *supra*. To discourage future such "dispositive" decisions, it is believed that this Honorable Court should reverse the present case alone on the ground that other genuine issues of material facts were by-passed in favor of a single issue which was thought to be dispositive. This case is believed an excellent example of the possibility of piecemeal appeals.

### “Stardust”.

The appellee makes the appeal that it is just “stardust” in our eyes to think that the patented process is anything more than the prior art.

The saving of millions of dollars over the best process used previously to remove sealant from aircraft tanks is not “stardust”. The experts had all the tank car and ship hull washing patents cited by the appellee. If these old methods could be used for the present purpose, why did the entire industry use a hand-scraping method and then the fill-soak-and-drain method? If it were obvious that the methods of these prior patents would do this work, why was all the money spent on said old methods for removal of sealant from aircraft tanks? Even when told of the patented process, the experts did not believe it would work! That is the finest of proof that it was not obvious.

The patented process is not “stardust” when it saves millions of dollars.

Since the appellant’s brief was filed, there has been published in the Los Angeles Daily Journal, to wit, on June 20, 1958, an article based on Senate Report No. 1430, entitled, “Patents, Trademarks and Copyrights”, in which report the Chairman of the Subcommittee investigating those subjects, Senator Joseph C. O’Mahoney of Wyoming, is reported as stating:

“The inventiveness, ingenuity, and technical skills of its citizens constitute the sinews of this nation’s economic and military strength. They comprise our most important safeguard of victory in the technological race with foreign powers. They ensure max-



imum scientific progress. One of the stimuli to inventiveness and technological advancement traditionally has been the patent system.”

It is believed that those who produce new inventions which are “the sinews of this nation’s . . . military strength” should be rewarded. Research on new ideas is expensive, and if protection is not given for new inventions, why should any person or corporation spend money in research for new ideas? It would be far cheaper to wait until a competitor has a successful invention and then just copy it. The patent laws were designed by our forefathers as a means of encouraging people to disclose their new ideas. Without a reward for doing so, inventors will cease to disclose their new ideas and they will be lost to the general public.

### Conclusion.

It is submitted that for the several reasons stated, the judgment of the lower court granting the present Motion for Summary Judgment should be reversed.

Respectfully submitted,

C. G. STRATTON,

LOUIS M. WELSH,

*Attorneys for Appellant Cee-Bee Chemical Co., Inc.*



No. 15,893  
IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

CEE-BEE CHEMICAL Co., INC., a corporation,  
*Appellant,*  
*vs.*  
DELCO CHEMICALS, INC., a corporation,  
*Appellee.*

---

PETITION FOR REHEARING.

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FULWIDER, MATTINGLY & HUNTLEY,  
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FILE

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No. 15,893  
IN THE  
**United States Court of Appeals**  
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---

CEE-BEE CHEMICAL Co., INC., a corporation,  
*Appellant,*  
*vs.*  
DELCO CHEMICALS, INC., a corporation,  
*Appellee.*

---

**PETITION FOR REHEARING.**

---

*To the Honorable Circuit Judges Hamley, Hamlin, and  
Jertberg of the United States Court of Appeals for  
the Ninth Circuit:*

Now comes Appellee (plaintiff in the declaratory relief action below) and petitions this Honorable Court for a rehearing of the above-entitled appeal on the ground that errors of fact and law appear in the opinion filed December 22, 1958, in accordance with which a judgment or decree was filed and entered reversing the judgment of the Court below and remanding the cause for trial; correction of said errors of fact and law would necessarily lead to a different conclusion and an affirmance of the summary judgment of the lower Court holding invalid Appellant-Defendant's patent in suit.

The grounds upon which this petition is based are as follows:

1. In holding that the trial court had resolved a disputed question of fact which was a necessary predicate to the conclusion that the Whitcomb patent was invalid,

the Court gave full credence to an affidavit of the inventor Whitcomb which showed on its face that it lacked the credibility necessary to raise a *genuine* issue as to a material fact;

2. In holding that the Whitcomb affidavit raised a genuine issue as to a material fact, the Court overlooked the fact that said affidavit contradicts the clear teachings of the patent in suit and so should have been disregarded because the inventor is estopped to attack the validity of his own patent;

3. The Court erroneously applied the rule of *Bergman v. Aluminum Lock Shingle Corp. of America* (C. A. 9), 251 F. 2d 801, in the light of Section 103 of Title 35, United States Code, in denying to the court below the power to decide the pure question of law as to whether any difference between the claimed subject matter and the prior art is such as to amount to invention within the meaning of the patent statutes; and

4. The Court erroneously concluded (despite express findings and conclusions to the contrary) that the trial court had been presented with genuine issues of material fact, both as to the prior art and the teaching of the Whitcomb patent, which it had resolved against the contested patent, apparently overlooking the fact that in finding lack of invention, the trial court held, properly and as a matter of law, that the method claimed, while involving some novelty, nonetheless lacked invention over prior art as to which no issue existed.

It is apparent from the Court's opinion that Appellee failed to emphasize sufficiently the above-mentioned matters of fact and law. It is to rectify that error that this petition is presented, so that the Court may be fully advised of the facts and circumstances entitling Appellee to a judicial declaration that the Whitcomb patent is invalid.

## ARGUMENT.

### Whitcomb Affidavit Does Not Raise a Genuine Issue as to a Material Fact.

The Court's opinion and judgment on this appeal was predicated on the assumption that the Whitcomb affidavit raised a genuine issue as to a material fact, which issue precluded favorable action on Appellee's motion for summary judgment. While the Whitcomb affidavit *appears* to raise a factual issue, Appellee submits that it does not actually do so—any such issue it might raise is not genuine.

The alleged issue in question concerns the inquiry as to whether the Foster patent No. 1,141,243 discloses the so-called "second step" of the Whitcomb patent in suit. This inquiry concerns only claims 1, 2, and 3; claims 4 through 8 do not recite the second step, and as to them there can be no issue. According to claims 2 and 3, the second step involves the application of a "water-rinsable, solvent-miscible spray," whereas, according to claim 1, the second step utilizes a "water-rinsable, emulsifying spray." Foster discloses the application of "soap or soap-like detergent material" [Foster p. 1, lines 26, 27; R. 238], a "detergent material" [Foster's claims 1-4, 9 and 10], and a "cleaning material" [Foster's claim 8].

According to the patent in suit, it is the purpose of the patented second step "to render the solvent-sealant solution in the tank water rinsable" [Whitcomb patent column 4, lines 29, 30; R. 228], or "restores the film to its initial solvent solution" [column 4, lines 41, 42] in order that "water may be employed for rinsing out the emulsified solution" [column 4, lines 31, 32]. According to Foster, it is the purpose of the like step "to effect a combining, mixing or emulsifying" [Foster patent p. 1, lines 32-34;

R. 238] of whatever it is that is “on the surface to be cleaned, so that by the further application of . . . water, a substantially cleaned surface will result” [p. 1, lines 35-38]; the substantially cleaned surface results because the emulsified mixture “is readily washed off with water” [p. 3, lines 25, 26; R. 240].

The substantial identity of the method steps, their purposes, and the results thereby achieved is clear—so clear that no *genuine* issue is raised by a self-serving affidavit asserting that the spray used in the patented second step is not soapy and that a soapy solution would not serve the purpose. Such an assertion should be ignored as completely as an assertion that black is white.

The Whitcomb affidavit [R. 87] asserts [R. 96] that “soap or a soapy solution is not solvent miscible,” and that the use thereof would “produce just the opposite results from those desired” [R. 97]. It is important to note that, genuine or not, the only issue raised by this assertion is whether Foster’s soap is the same as the material called for by Whitcomb’s claims 2 and 3.

What the Whitcomb affidavit does not assert is even more important; he does not assert that a spray of soap or of a soapy solution is not a “water-rinsable, emulsifying spray” (claim 1 of the patent in suit), and he does not assert that Foster’s “soap-like detergent material,” or “detergent material,” or “cleaning material” is unlike the materials specified in the claims of the patent in suit, and he does not assert that these other materials of Foster would not work. In short, as to these other materials there is no dispute, and the trial court was required only to determine that Appellee was entitled to a judgment as a matter of law.



## Whitcomb Affidavit Must Be Disregarded Because the Patentee Is Estopped to Take a Position Antagonistic to the Validity of His Patent.

If Whitcomb's affidavit is to be believed, he makes assertions that invalidate claims 3 through 8 of his patent. This being directly contrary to the averments of the oath accompanying his patent application and being in derogation of the property (the patent) transferred to his assignee (Appellant), Whitcomb is estopped now to make such assertions; his affidavit must be disregarded. (*U. S. Appliance Corp. v. Beauty Shop Supply Co., Inc.* (C. A. 9), 121 F. 2d 149.)

That part of the Whitcomb affidavit [R. 96, 97] which is quoted as footnote 3 to the Court's opinion of December 22 asserts that the so-called "second step" is essential to the successful practice of the invention, and that to follow the solvent spray with a water spray would cause the sealant to be re-set, rather than removed. Thus, according to Whitcomb's affidavit, to omit the second step is to render the process inoperative—yet this is what claims 4 through 8 do; each one of these claims calls for following the solvent spray with a water spray. Claims that define an inoperative process are invalid.

Not only is Whitcomb estopped to take such a position, but the inherent improbability of such assertions requires them to be disregarded, and this includes those concerning the soap or soapy solution.

When the Whitcomb affidavit is disregarded as it should be, it is seen that there does not exist any genuine issue as to any material fact which would preclude the trial court from entering a summary judgment. The judgment below should be affirmed.

**It Was Not Improper for the Trial Court to Conclude  
as a Matter of Law That the Patented Method  
Lacked Invention.**

According to *Bergman v. Aluminum Lock Shingle Corp. of America*, 251 F. 2d 801 (which this Court attempted to follow), the nature of the prior art and the nature of what the patentee did to improve upon it are questions of fact; whether what the patentee did is to be called an invention is a question of law. However, in the case at bar, the Court held erroneously that the trial court had resolved against the contested patent genuine issues of material fact which had been presented as to the prior art and the teaching of the Whitcomb patent. This conclusion was predicated upon the previously discussed disputes centering around the Foster patent.

In deciding that the Whitcomb patent in suit lacked invention, the trial court did not resolve any genuine issues of material fact, as will be seen from the following explanation:

The “Memorandum of Decision” filed December 11, 1957, was incorporated by reference into the trial court’s findings of fact [Finding No. 26, R. 152]. One of the findings thus incorporated is the following:

“So in the case at bar, even if the disclosures of the *non-cited-prior-art patents* be said to fall short of complete anticipation, *they* still serve upon the motion for summary judgment to negative invention, and thus to render invalid the patent in suit since, as has been shown, no presumption of validity can subsist as to the non-cited-prior art patents.

“This alone is sufficient to dispose of the case on the merits.” [R. 144.] (Emphasis added.)

The Foster patent No. 1,141,243, discussed by this Court in its opinion and as to which this Court concluded that the Whitcomb affidavit raised an issue of fact, was one of the patents cited by the Patent Office [see Finding No. 10, R. 148]; it was not one of the “non-cited-prior-art patents” referred to by the trial court in the above quotation and listed in its Finding No. 12 [R. 149]. Pursuant to the foregoing, the trial court concluded, as a matter of law:

“The patent in suit, and each of its claims, are invalid and void, for want of invention over the prior art.” [ Conclusion of Law No. 4, R. 153.]

This conclusion was reached independently of any alleged question of fact concerning the Foster patent; it was expressly based upon a collection of prior art patents which did not include the Foster patent. Thus, the trial court’s conclusion that Whitcomb lacked invention involved only a question of law which it was proper to decide by summary judgment.

### Conclusion.

From the foregoing it clearly appears (1) that the Whitcomb affidavit does not raise any *genuine* issue of fact; (2) that the substantial identity of the method steps, their purposes, and the results thereby achieved by the Foster patent and the patent in suit is so clear that a genuine issue of fact cannot be raised by an affidavit which merely denies the truth of a self-evident proposition; (3) that the alleged issue of fact raised by the Whitcomb affidavit applies only to two or three of the eight claims of the patent in suit; (4) that the Whitcomb affidavit must be disregarded because of estoppel and because of the inherent improbability of the assertions

therein made; and (5) that resolution of the issue allegedly raised by the Whitcomb affidavit was not a predicate to the trial court's conclusion of law that the patented method lacked invention—that conclusion was not based upon any finding of fact regarding the allegedly disputed issue.

For the reasons stated above, Appellee requests that a rehearing be granted and that on such rehearing the judgment of this Court be revised to affirm the judgment of the court below.

Dated this 20th day of January, 1959.

Respectfully submitted,

FULWIDER, MATTINGLY & HUNTLEY,  
and

WALTER P. HUNTLEY,

By WALTER P. HUNTLEY,

*Attorneys for Appellee.*

---

### Certificate.

I hereby certify that the foregoing Petition for Rehearing is not presented for the purpose of delay but is filed in good faith and is, in the judgment of counsel, well founded in law and proper to be filed herein.

Dated this 20th day of January, 1959.

WALTER P. HUNTLEY,

*Attorney for Appellee.*

No. 15,896

IN THE

United States Court of Appeals  
For the Ninth Circuit

---

MORRIS ALBERT,

*Appellant,*

VS.

UNITED STATES OF AMERICA,

*Appellee.*

On Appeal from the District Court of the United States  
for the District of Alaska, Fourth Judicial Division.

BRIEF FOR APPELLEE.

---

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Fairbanks, Alaska,

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FILE

MAY 6 1958

PAUL P. O'BRIEN,





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No. 15,896

IN THE

**United States Court of Appeals  
For the Ninth Circuit**

---

MORRIS ALBERT,

*Appellant,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

**On Appeal from the District Court of the United States  
for the District of Alaska, Fourth Judicial Division.**

**BRIEF FOR APPELLEE.**

---

**JURISDICTION.**

Jurisdiction of the District Court was invoked pursuant to the Act of June 25, 1948, c. 646, 62 Stat. 967, as amended May 24, 1949, c. 139, sec. 114, 63 Stat. 105; 28 U.S.C. 2255.

Jurisdiction of this Court was invoked pursuant to the Act of June 25, 1948, c. 646, 62 Stat. 967, as amended May 24, 1949, c. 139, sec. 114, 63 Stat. 105; 28 U.S.C. 2255.

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**COUNTERSTATEMENT OF THE CASE.**

On the 14th day of February, 1956, an indictment was returned by the grand jury for the Fourth

Judicial Division, District of Alaska, charging the appellant with the crime of robbery, in violation of Section 65-4-24 of the Alaska Compiled Laws Annotated, 1949. On February 15, 1956, District Judge Vernon D. Forbes appointed Eugene V. Miller, a member of the local and territorial bar, to represent the appellant. Thereafter, on the same day, appellant was arraigned in the District Court for the District of Alaska, Fourth Judicial Division, and entered a plea of not guilty.

On the 14th day of May, 1956, the trial was held in the District Court, wherein the appellant was represented by Mr. Miller, and a verdict of guilty was returned by the jury. On May 21, 1956, District Judge Vernon D. Forbes committed the appellant to the custody of the Attorney General or his authorized representative for a period of fifteen years. On May 29, 1956, appellant filed a notice of appeal with the Clerk of the District Court, but no further action was taken to perfect the appeal.

On May 28, 1957, Judge Vernon D. Forbes entered an order denying appellant's motion under 28 USCA §2255 to vacate the sentence. (See appendix.)

On June 21, 1957, the Ninth Circuit Court of Appeals denied appellant's "Petition for Motion of De Novo".

On November 5, 1957, the appellant filed a motion to vacate his sentence in the office of the Clerk of the District Court for the District of Alaska, Third Judicial Division. The Honorable J. L. McCarrey, Jr.,



District Judge for the Third Judicial Division, entered a minute order on November 15, 1957, transferring the motion to Fairbanks, Alaska, for the reason that the defendant was tried and sentenced in the Fourth Judicial Division.

Judge Forbes entered an order on November 27, 1957, denying appellant's second motion to vacate the sentence. (See appendix.)

Appellant has appealed to this Court from the denial of his second motion to vacate the sentence.

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### **QUESTION PRESENTED.**

Whether the District Court erred in not entertaining appellant's second motion made pursuant to 28 USCA §2255 to vacate the sentence.

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### **ARGUMENT.**

**THE DISTRICT COURT WAS NOT REQUIRED TO ENTERTAIN APPELLANT'S SECOND MOTION TO VACATE THE SENTENCE.**

On May 28, 1957, the Honorable Vernon D. Forbes, District Judge for the Fourth Judicial Division, entered an order denying appellant's first motion to vacate his sentence on the grounds that a consideration of the motion and an examination of the files and records of the case conclusively showed that appellant was entitled to no relief. Judge Forbes had appointed counsel for the appellant and presided at the trial. Appellant did not appeal from the Court's

order of May 28, 1957, but on November 5, 1957, filed another motion with the Clerk of Court in the Third Division at Anchorage, Alaska. After the second motion was transferred to Fairbanks, on November 27, 1957, the District Court for the Fourth Judicial Division, entered an order denying this motion to vacate for the reason that the sentencing court, in its discretion, was not required to entertain a second or successive motion under 28 USCA §2255 for similar relief on behalf of the same prisoner. *Bickford v. United States*, 206 F.2d 395 (9th Cir. 1953); *Moss v. United States*, 177 F.2d 438 (10th Cir. 1949); *Shobe v. United States*, 220 F.2d 928 (8th Cir. 1955); *United States v. Brown*, 207 F.2d 310 (7th Cir. 1953).

The appellant in his brief has failed to set forth any facts, which would support his contention that the District Court abused its discretion.

Substantially the allegations and conclusions pleaded in his second motion were presented to the Court in his first motion. The appellant should have presented facts to the Court, not merely his conclusions. *United States v. Trumblay*, 234 F.2d 273, 275 (7th Cir. 1956).

Appellant further alleges that a hearing should have been granted and he should have been present. The District Judge found from the first motion and the files and records of the case that the prisoner was entitled to no relief; therefore, it was not necessary to have a hearing. If the Court finds a hearing is

necessary, then, only when there are substantial issues of fact as to events in which the prisoner participated it is necessary for the trial Court to require his production for the hearing. *United States v. Hayman*, 342 U.S. 205, 223 (1952).

Appellant in his brief and motions presents many criticisms which are not supported by the record.

---

### CONCLUSION.

It is respectfully submitted that the order of the District Court denying to entertain appellant's second motion under 28 USCA §2255 should be affirmed.

Dated, Fairbanks, Alaska,  
April 30, 1958.

GEORGE M. YEAGER,  
United States Attorney,

JAY A. RABINOWITZ,  
Assistant United States Attorney,  
*Attorneys for Appellee.*

(Appendix Follows.)



## **Appendix.**





Appendix

In the District Court for the District of Alaska  
Fourth Judicial Division

No. 2126 Cr.

United States of America,

Plaintiff,

vs.

Morris Albert,

Defendant.

**ORDER**

The defendant in the above entitled case, being a prisoner in custody under sentence of this Court, has filed what I will treat as a Motion to Vacate, set aside or correct the sentence of this Court; the Motion being filed, I believe, under the provisions of 28 U.S.C., Section 2255.

I have carefully considered said Motion and have examined the files and records of the case, all of which conclusively show that the prisoner is entitled to no relief and I, therefore, respectfully deny said Motion.

Done at Fairbanks, Alaska, this 28th day of May, 1957.

/s/ Vernon D. Forbes,

District Judge.

208 Fed. Rep. 2d Series, page 902

222 Red. Rep. 2d Series, page 45

224 Fed. Rep. 2d Series, page 866

234 Fed. Rep. 2d Series, page 835

Filed. In the District Court, Territory  
of Alaska, 4th Div., May 28, 1957.

John B. Hall, Clerk.

By /s/ G. B. Swenson,

In the District Court for the District of Alaska  
Fourth Judicial Division

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No. 2126 Cr.

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United States of America,	} Plaintiff,
vs.	
Morris Albert,	
	} Defendant.

ORDER

On February 18, 1957, defendant, in the above entitled case, filed in this Court three documents, respectively captioned: "Petition for Disqualification of Judge", "Petition for Change of Venue" and "Petition of Motion to Vacate Sentence". The Court treated defendant's "Petition of Motion to Vacate Sentence" as a motion made pursuant to 28 U.S.C.A., §2255 and by Order made and entered on May 28, 1957, denied defendant's "Petition of Motion to Vacate Sentence". Simultaneously, defendant's "Petition for Change of Venue" was in substance and effect denied, as this Court in treating defendant's "Petition of Motion to Vacate Sentence" as a motion made under 28 U.S.C.A. §2255, was the Court required to determine the motion.<sup>1</sup> Defendant's "Petition for

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<sup>1</sup>28 U.S.C.A., §2255 provides in part: "A prisoner in custody under sentence of a court established by Act of Congress . . . may move the court which imposed the sentence to vacate, set aside or correct the sentence":

Disqualification of Judge” was in substance and effect also denied at that time as defendant made no showing in support of this petition.<sup>2</sup>

Thereafter on September 9, 1957, defendant filed a second “Petition of Disqualification of Judge”. No affidavit or statement containing facts and reasons in support of defendant’s Petition was filed, the Petition itself contained, in full, the following language:

“I hereby ask you to disqualify yourself from my forthcoming Petition of this case and commitment No. 2126 Cr.”.

On December 12, 1957, the Court entered an Order denying defendant’s second “Petition of Disqualification of Judge”.

Thereafter, defendant filed in the office of the Clerk of the District Court for the District of Alaska, Third Judicial Division, on November 5, 1957, in the above entitled case, a “Petition to Vacate Sentence”, “Brief of Disqualification” and “Brief”. By Minute Order made and entered on November 15, 1957, the Honor-

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<sup>2</sup>See §54-2-1, A.C.L.A., 1949 which provides in part:

“Fifth. Whenever any party, or any attorney for any party, to any action or proceeding, civil or criminal, shall make and file an affidavit that the judge before whom the action or proceeding is to be tried or heard has a personal bias or prejudice either against him or his attorney or in favor of any opposite party, or attorney for an opposite party, to the suit, and that it is made in good faith and not for the purpose of delay. Every such affidavit shall state the facts and the reasons for the belief that such bias or prejudice exists, and shall be filed within one day after such action, suit, or proceeding is at issue upon a question of fact, or good cause shall be shown for the failure to file it within such time. No party or attorney shall be entitled to file more than one such affidavit in any case. The provisions of this subdivision shall apply only to the District Court. See also, 28 U.S.C.A., §455.”

able J. L. McCarrey, Jr., District Judge, upon his own motion, ordered that:

“... the motion to vacate sentence is hereby transferred to Fairbanks, Alaska for hearing for the reason defendant was tried and sentenced in Fairbanks”.

Title 28 U.S.C.A., §2255 provides in part:

“The sentencing court shall not be required to entertain a second or successive motion for similar relief on behalf of the same prisoner”.

Defendant's current “Petition to Vacate Sentence” and “Brief” in support thereof raise substantially the same grounds presented in his first “Petition to Vacate Sentence”. Again treating this Petition as a motion made pursuant to 28 U.S.C.A., §2255 and exercising the discretion given by virtue of the above quoted portion of 28 U.S.C.A., §2255, defendant's current “Petition to Vacate Sentence” will not be entertained by this Court.<sup>3</sup>

As to defendant's “Brief of Disqualification” (treated herein as a motion to disqualify the undersigned), defendant has failed to allege any facts or reasons in support thereof.

It Is Hereby Ordered that defendant's “Petition to Vacate Sentence” dated October 18, 1957, be Denied.

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<sup>3</sup>*Moss v. United States*, 1949, 177 F.2d 438; *Dunn v. United States*, 1956, 234 F.2d 219; *Corcoran v. United States*, 1956, 231 F.2d 449; *United States v. Sanders*, 1955, 138 F.Supp. 192; *Jackson v. United States*, 1955, 224 F.2d 556.



It Is Hereby Further Ordered that defendant's "Brief of Disqualification" be Denied.

Done at Fairbanks, Alaska, this 27th day of November, 1957.

/s/ Vernon D. Forbes  
United States District Judge

Filed. In the District Court, Territory  
of Alaska, 4th Div., Nov. 27, 1957.

John B. Hall, Clerk.

By /s/ Kleve Rae Wiegand,  
Deputy.

## ALASKA COMPILED LAWS ANNOTATED, 1949.

§65-4-24. *Robbery: Larceny from person.* That whoever, by force or violence, or by putting in fear, steals and takes from the person of another anything of value, is guilty of robbery, and shall be imprisoned in the penitentiary not more than fifteen years nor less than one year; and whoever, otherwise than by force and violence or by putting in fear, shall steal and take from the person of another anything of value, shall be imprisoned in the penitentiary not exceeding five years nor less than one year.

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## UNITED STATES CODE ANNOTATED.

28 §2255. *Federal custody: remedies on motion attacking sentence.*

A prisoner in custody under sentence of a court established by Act of Congress claiming the right to be released upon the ground that the sentence was imposed in violation of the Constitution or laws of the United States, or that the court was without jurisdiction to impose such sentence, or that the sentence was in excess of the maximum authorized by law, or is otherwise subject to collateral attack, may move the court which imposed the sentence to vacate, set aside or correct the sentence.

A motion for such relief may be made at any time.

Unless the motion and the files and records of the case conclusively show that the prisoner is entitled to no relief, the court shall cause notice thereof to be

No. 15898 ✓

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United States  
Court of Appeals  
for the Ninth Circuit

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ARTHUR V. MORGAN and DOROTHY O.  
MORGAN, Petitioners.

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of Record

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Petition to Review a Decision of The Tax  
Court of the United States

FILED

APR - 9 1958

PAUL P. O'BRIEN, CLERK



No. 15898

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United States  
Court of Appeals  
for the Ninth Circuit

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ARTHUR V. MORGAN and DOROTHY O.  
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vs.

COMMISSIONER OF INTERNAL REVENUE,  
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Transcript of Record

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Petition to Review a Decision of The Tax  
Court of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## NAMES AND ADDRESSES OF ATTORNEYS

LEONARD B. HANKINS,  
4014 Long Beach Boulevard,  
Long Beach 7, California,  
Attorney for Petitioners.

CHARLES K. RICE,  
Assistant Attorney General,

LEE A. JACKSON,  
Attorney,  
Department of Justice,  
Washington 25, D. C.,  
Attorneys for Respondent.



The Tax Court of the United States

Docket No. 56621

ARTHUR V. MORGAN and DOROTHY O.  
MORGAN, Petitioners,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DOCKET ENTRIES

1955

Mar. 3—Petition received and filed. Taxpayer notified. Fee paid.

Mar. 4—Copy of petition served on General Counsel.

Mar. 3—Request for Circuit hearing in Los Angeles, Calif. filed by taxpayer. 3/8/55—Granted.

Apr. 29—Answer filed by General Counsel.

May 3—Copy of answer served on taxpayer—Los Angeles, Calif.

Jun. 25—Motion to withdraw George A. Hart, Jr. and M. B. Kambel, as counsel, filed. Granted 6/25/56.

Jun. 25—Entry of appearance of Leonard B. Hankins, as counsel filed.

1956

Oct. 19—Hearing set Jan. 7, 1957, Los Angeles, Calif.

1957

- Jan. 11—Trial had before Judge Atkins on merits. Stipulation of Facts with exhibits 1-A thru 6-F, filed at hearing. Petitioner's brief due 2/25/57, Respondent's brief due 3/27/57, Petitioner's Reply due 4/26/57.
- Feb. 1—Transcript of Hearing 1/11/57 filed.
- Feb. 25—Brief for Petitioner filed. Served 2/25/57.
- Mar. 27—Brief for Respondent filed. Served 3/28/57.
- Apr. 25—Reply Brief for Petitioner filed. Served 4/25/57.
- Oct. 17—Findings of Fact and opinion filed. Judge Atkins. Decision will be entered for the respondent. Served 10/18/57.
- Oct. 17—Decision entered — Judge Atkins. Served 10/21/57.

1958

- Jan. 7—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by petitioner.
- Jan. 7—Proof of service filed.
- Jan. 7—Designation of contents of record on review with proof of service, thereon.

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[Title of Tax Court and Cause.]

## PETITION

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Ap:LA:AA-EWM 90-D ICA) dated

December 6, 1954, and as a basis of their proceeding allege as follows:

1. Petitioners are individuals whose principal residence is 4400 Myrtle Avenue, Long Beach 7, California. The return for the period here involved was filed with the Collector of Internal Revenue for the Sixth District, Los Angeles, California.

2. The notice of deficiency was mailed to petitioners on December 6, 1954. Attached hereto and marked Exhibit A is a copy of said notice, together with pages 1 and 2 of the statement which accompanied the notice.

3. The deficiency as determined by the Commissioner is in income taxes for the calendar year 1950 in the amount of \$4,076.40, of which \$3,952.82 is in dispute.

4. The determination of the tax set forth in the said notice of deficiency is based upon the following error:

In determining the tax liability of petitioners for the calendar year 1950, the Commissioner erroneously included in the taxable net income of Art Morgan Motor Company, a partnership, for the period ended December 31, 1950, an amount of \$15,764.32 in respect of a finance reserve maintained by Farmers and Merchants Bank of Long Beach and applicable to said partnership. Upon the basis of the inclusion of said amount in the taxable income of the partnership, the Commissioner erroneously increased the taxable income of petitioners



for 1950 by the amount of \$11,823.24, being 75% of the addition to the partnership's income in accordance with petitioners' 75% interest in the partnership.

5. The facts upon which petitioners rely as the basis of this proceeding are as follows:

(a) Art Morgan Motor Company was a partnership organized January 7, 1950 in which Arthur V. Morgan owned a 75% interest. Said partnership engaged in the retail automobile business and sold automobiles for cash and on conditional sales contracts.

(b) During the taxable period ended December 31, 1950 conditional sales contracts received by said partnership were simultaneously assigned at a discount to Farmers & Merchants Bank of Long Beach, California, with recourse.

(c) The full amount of the discounts was excluded from the income of the partnership; only the net amount of cash received on each contract was recognized as income.

(d) The Farmers & Merchants Bank followed a practice of setting aside as a "reserve" a portion of the amount by which conditional sales contracts were discounted upon assignment, said portion being subject to possible future payments to the partnership; however, there was no written agreement obligating the bank so to do, or obligating it to make any payments to the partnership from such reserve.

(e) It was customary for the bank to make payments to Art Morgan Motor Company, in respect of this reserve at such times as and to the extent the accumulations therein exceeded the sum of 10% of contract balances and 100% of delinquent or other accounts which might to the bank appear questionable.

(f) Any interest of the partnership in the funds represented by such reserve was absolutely contingent upon the bank receiving collections on the contracts in due course, and no right whatsoever, either ultimately or currently, in or to the reserve accrued to the partnership prior to the time amounts were paid to it by the bank.

(g) The income tax return of petitioners for the year here involved was duly filed on or before March 15, 1951 with the Collector of Internal Revenue, Sixth District, Los Angeles, California.

(h) The notice of deficiency was mailed as alleged under 2 above.

Wherefore, petitioners pray that this Court may hear the proceeding and determine that there is no deficiency in excess of \$123.58 due from petitioners for the calendar year 1950.

/s/ GEORGE A. HART, JR.,

/s/ M. B. KAMBEL,

Attorneys for Petitioner.

Of Counsel:

BALL, HUNT AND HART.

Duly Verified.

## EXHIBIT "A"

## U. S. TREASURY DEPARTMENT

Internal Revenue Service  
Regional Commissioner  
1250 Subway Terminal Building  
417 South Hill Street  
Los Angeles 13, California

Dec. 6, 1954

In Replying Refer to Ap:LA:AA-EWM 90-D  
ICA.

Mr. Arthur V. Morgan and  
Mrs. Dorothy O. Morgan  
Husband and Wife  
4400 Myrtle Avenue  
Long Beach 7, California

Dear Mr. and Mrs. Morgan:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1950 discloses a deficiency of \$4,076.40, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Colum-

bia in which event that day is not counted as the 90th day. Otherwise, Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute, in duplicate, the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earliest.

Very truly yours,

T. COLEMAN ANDREWS,  
Commissioner of Internal  
Revenue,

By H. L. DUCKER,  
Special Assistant, Appellate  
Division.

Enclosures:

Statement

Form 1276

Agreement Form

Ap:LA:AA-EWM

90D:ICA

## STATEMENT

Mr. Arthur V. Morgan and  
 Mrs. Dorothy O. Morgan  
 (Husband and Wife)  
 4400 Myrtle Avenue  
 Long Beach 7, California

Tax Liability for the Taxable Year  
 Ended December 31, 1950

	Deficiency
Income Tax.....	\$4,076.40

In making this determination of your income tax liability, careful consideration has been given to your protest dated May 19, 1954, and to the statements made at the conferences held on September 30, 1954 and October 14, 1954.

A copy of the letter and a copy of this statement have been mailed to your representatives, Mr. M. B. Kambel and Mr. A. C. Hauck, Jr., 120 Linden Avenue, Long Beach 2, California, in accordance with the authorization contained in the power of attorney executed by you.

## Year 1950

## Adjustments to Net Income

Net income disclosed by the amended return .....	\$ 8,656.68
Unallowable deductions and Additional income:	

(a) Adjustment of partnership income from Art Morgan Motor Company .....	13,454.49
(b) Adjustment of interest income .....	3,663.80
(c) Disallowance of deduction for note expense ..	798.00
(d) Disallowance of deduction for interest ex- pense .....	1,250.00
(e) Disallowance of deduction for automobile ex- pense .....	875.00

Total .....	\$28,697.97
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## Nontaxable income and Additional deductions:

(f) Adjustment of partnership loss from B&B Motor Sales .....	461.30
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Net income as revised .....	\$28,236.67
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## Year 1950 (Continued)

## Explanation of Adjustments

(a) Your partnership income from Art Morgan Motor Company is increased \$13,454.49. Computation of adjustment is shown below:

Ordinary net income of Art Morgan Motor Company partnership as disclosed by the return, Account No. 8858128 .....	\$14,764.37
Add:	
(1) Income from sales of Conditional Sales Contracts .....	\$15,764.32
(2) Adjustment of deduction for rent .....	500.00
(3) Disallowance of purchase deduction for automobile .....	1,675.00
Ordinary net income as revised .....	\$32,703.69
Your 75% partnership interest .....	\$24,527.77
Partnership income from Art Morgan Motor Company shown on your return .....	11,073.28
Increase in partnership income .....	\$13,454.49

(1) In determining the correct distributable income from Art Morgan Motor Company, it is held that the gross selling price of the Conditional Sales Contracts, sold to the Farmers and Merchants National Bank of Long Beach, California, constitutes income in the year sold under the provisions of section 22(a) of the Internal Revenue Code (1939). Further, it is held that the amount which you seek to exclude from the partnership's gross income (\$15,764.32) is not a deductible item under any provision of the Internal Revenue Code (1939).

[Endorsed]: T.C.U.S. Filed March 3, 1955.

[Title of Tax Court and Cause.]

## ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service, and for answer

to the petition filed by the above-named petitioners, admits and denies as follows:

1, 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the deficiency as determined by the Commissioner is in income taxes for the calendar year 1950 in the amount of \$4076.40, but denies the remaining allegations of paragraph 3 of the petition.

4. Denies the allegations contained in paragraph 4 of the petition.

5 (a). Admits the allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that during the taxable year ended December 31, 1950, the partnership assigned and sold conditional sales contracts to the Farmers and Merchants Bank of Long Beach, California; but denies the remaining allegations of subparagraph (b) of paragraph 5 of the petition.

(c) Admits that the partnership did not report as income the gross sales price received on the sale of conditional sales contracts, but has no information or belief on the matter sufficient to enable him to answer the remaining allegations as contained in subparagraph (c) of paragraph 5 of the petition and hence denies the same.

(d) Respondent has no information or belief on the matter sufficient to enable him to answer the allegations of fact, if any, set out in subparagraph

(d) of paragraph 5 of the petition and hence denies the same.

(e) Respondent has no information or belief on the matter sufficient to enable him to answer the allegations of fact, if any, set out in subparagraph (e) of paragraph 5 of the petition and hence denies the same.

(f) Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition.

(g) Admits the allegations contained in subparagraph (g) of paragraph 5 of the petition.

(h) Admits the allegations contained in subparagraph (h) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the determination of the Commissioner be sustained.

/s/ R. P. HERTZOG, REM,  
Acting Chief Counsel,  
Internal Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel,  
E. C. Crouter, Assistant Regional Counsel,  
R. E. Maiden, Jr., Special Assistant to the Regional Counsel, Harold W. Vestermark, Attorneys, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed April 29, 1955.

[Title of Tax Court and Cause.]

## STIPULATION OF FACTS

It is stipulated that the following facts may be received in evidence without further proof; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts stipulated; and provided, further, that both parties to this stipulation reserve the right to object to the materiality and relevancy of any of the facts herein stipulated.

1. The petitioners are husband and wife residing at 4400 Myrtle Avenue, Long Beach, California. Their joint income tax return for the calendar year 1950 was filed with the Collector of Internal Revenue for the 6th District of California on or before March 15, 1951.

2. Arthur V. Morgan, the petitioner herein, and Frank D. Lortscher formed a partnership doing business as Art Morgan Motor Company (hereinafter referred to as the partnership) in Long Beach, California, on January 7, 1950. The petitioner held a 75% interest, and Frank D. Lortscher held a 25% interest throughout the taxable period in question.

3. The partnership filed an income tax return for the taxable period January 7, 1950, to December 31, 1950, with the Collector of Internal Revenue for the 6th District of California.

4. The partnership's books and records were maintained on the accrual basis of accounting.

5. The partnership was actively engaged in the purchase and retail sale of used automobiles.

6. A large number of automobiles sold by the partnership were sold pursuant to conditional sale contracts (hereinafter referred to as Contracts or Contract), the terms of which are set forth in Exhibit 1-A attached hereto. Exhibit 1-A is a document with two sides.

7. In all transactions pertinent herein, the partnership assigned the Contract to the Farmer's and Merchant's Bank of Long Beach, California (hereinafter referred to as the Bank).

8. From January 7, 1950, to July 1, 1950, the partnership assigned the Contracts to the Bank pursuant to both the terms of the assignment captioned "Seller's Guaranty and Assignment (With Recourse)" in Exhibit 1-A and the terms of an oral agreement which included the terms set forth in paragraph 10 of Exhibit 2-B attached hereto.

9. From July 1950, and throughout the remainder of the taxable period in question, the partnership assigned the Contracts to the Bank pursuant to both the terms of the assignment captioned "Seller's Warranty of Title and Assignment (Without Recourse)" in Exhibit 1-A, and the terms of the written agreement, attached hereto as Exhibit 2-B.

10. The following example is typical, except for



the sums, of the Contracts entered into by the partnership during the taxable period in question:

1. Cash Purchase Price .....	\$2,795.00
2. Sales Tax .....	83.85
3. Total Cash Purchase Price .....	2,878.85
4. Less: Down-payment .....	1,645.85
<hr/>	
5. Unpaid Cash Purchase Price .....	1,233.00
6. Add: Motor Vehicle Tax .....	40.00
<hr/>	
7. Unpaid Balance .....	1,273.00
8. Add: Time Price Differential .....	143.15
(Finance Charges or Interest)	
<hr/>	
9. Contract Balance .....	\$1,416.15

11. During the taxable period in question, the entries to the Reserve Account on the books of the Bank were recorded by the partnership in a memorandum account; the partnership did not record them in a general ledger account, nor did it reflect them in any of its financial statements.

12. The Bank informed the partnership of entries to the Reserve Account and periodically sent the partnership statements showing the balance in the Reserve Account.

13. During the taxable period in question, some of the purchasers in the Contracts which the partnership assigned to the Bank paid off the Contract prior to its normal maturity date, and, accordingly, under applicable State law, to-wit, Section 2892 of the California Civil Code, were not obliged to pay the entire sum designated "Time Price Differential" in item 7 of Exhibit 1-A, but only a lesser sum. In these circumstances the Bank debited

the Reserve Account for a portion of the sum that was no longer due from the purchaser.

14. The following schedule shows a) the names of some purchasers in conditional sale contracts assigned by the partnership to the Bank, b) the amount credited by the Bank to the Reserve Account upon the assignment to it of each of the Contracts, and c) the amount debited by the Bank to the Reserve Account upon the payoff by the purchasers of the Contract prior to its normal maturity date:

(a)		(b)		(c)	
Name of Car		Credits to		Debits to	
		Reserve Account		Reserve Account	
Purchaser	Date	Amount		Date	Amount
Finley	1/21/50	\$ 29.90		2/17/50	\$ 19.90
Williams	3/27/50	15.40		6/ 3/50	2.20
Barker	6/ 1/50	106.00		6/15/50	88.32
McConnell	5/27/50	49.35		7/20/50	30.00
Barrett	6/20/50	52.24		6/29/50	52.24
Welch	4/14/50	84.21		8/10/50	56.01
Van Meter	7/14/50	50.80		8/16/50	37.53
Kennedy	8 /2/50	107.57		8/18/50	94.37
Schuler	8/ 4/50	211.55		8/29/50	153.40

This schedule is merely illustrative and does not set forth every instance during the taxable period in question where the Reserve Account was debited upon the payoff by the purchasers of the Contract prior to its normal maturity date.

15. During the taxable period in question, the credit balance in the Reserve Account never exceeded 10% of the then aggregate unpaid balances of the Contracts assigned by the partnership to the Bank, and the Bank was not required to, and did

not, make any payments to the partnership in pursuance of the terms of the agreement contained in paragraph 10 of Exhibit 2-B.

16. During the taxable period in question, the credits to the Reserve Account totaled \$16,895.08, and the debits thereto totaled \$1,130.76, leaving a credit balance of \$15,764.32.

17. The partnership did not report as taxable income for the period in question any of the credits to the Reserve Account or any of the \$15,764.32 credit balance therein; nor did it report any of the debits as a deduction.

18. In determining the deficiency in question, the respondent increased the partnership's taxable income for the taxable year 1950 by the sum of \$15,764.32 representing the credit balance in the Reserve Account as of the end of the taxable year 1950.

19. The partnership did not claim a bad debt deduction for the taxable period in question.

20. The Bank did not give any consideration to the fair market value of any Contract in purchasing it from the partnership.

21. At all times material herein, the Bank was financially sound and able to pay any amount due to the partnership.

22. Attached hereto as Exhibit 3-C is a copy of the Partnership return for the taxable year 1950.

23. Attached hereto as Exhibit 4-D is a copy of

the petitioners' income tax return for the taxable year 1950.

24. Attached hereto as Exhibit 5-E is a copy of the Petitioners' amended income tax return for the year 1950.

25. Attached hereto as Exhibit 6-F is Section 2892 of the California Civil Code which was in effect throughout the taxable period in question.

/s/ LEONARD B. HANKINS,  
Counsel for Petitioners.

/s/ JOHN POTTS BARNES, ECC,  
Chief Counsel, Internal Revenue Service, Counsel  
for Respondent.

[Endorsed]: T.C.U.S. Filed Jan. 11, 1957.

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29 T. C. No. 9

Tax Court of the United States

Arthur V. Morgan and Dorothy O. Morgan, Petitioners v. Commissioner of Internal Revenue, Respondent.

Docket No. 56621. Filed October 17, 1957.

#### FINDINGS OF FACT AND OPINION

Amounts retained by the purchaser of an automobile dealer's deferred payment contracts and credited to a reserve account on the books of the purchaser, held to be accruable income to the dealer in the year of sale of the contracts even though the amount of the reserve at the close of the year was not sufficient to allow the dealer to demand pay-

ment of any part thereof. Shoemaker-Nash, Inc., 41 B.T.A. 417, and Albert M. Brodsky, 27 T.C. 216, followed.

Leonard B. Hankins, Esq., for the petitioners.

Joseph G. White, Jr., Esq., for the respondent.

Atkins, Judge:

The respondent determined a deficiency in income tax for the calendar year 1950 in the amount of \$4,076.40. The petitioner Dorothy O. Morgan is a party only by reason of having signed the joint income tax return for the year 1950.

The respondent made several adjustments to the reported income in determining the deficiency. The only issue is whether an automobile dealer partnership, of which the petitioner Arthur V. Morgan was a member, realized income through credits to a reserve account on the books of a bank to which the partnership assigned conditional sales contracts.

### Findings of Fact

Some of the facts were stipulated and as so stipulated are incorporated herein by this reference.

The petitioners are husband and wife, residing at Long Beach, California. Their joint income tax return for the calendar year 1950 was filed with the collector of internal revenue for the sixth district of California. The petitioner Arthur V. Morgan will hereinafter be referred to as the petitioner.

The petitioner and Frank D. Lortscher formed a partnership doing business as Art Morgan Motor Company (hereinafter referred to as the partnership) in Long Beach, California, on January 7,



1950. The petitioner held a 75 percent interest and Lortscher held a 25 percent interest. The partnership kept its books and returned its income on an accrual method of accounting. It filed an income tax return for the taxable period January 7, 1950 to December 31, 1950, with the collector of internal revenue for the sixth district of California.

The partnership was actively engaged in the purchase and retail sale of used automobiles. A large number of automobiles were sold under conditional sales contracts. In all such sales the conditional sales contracts were simultaneously assigned by the partnership to Farmers & Merchants Bank, Long Beach, California, hereinafter referred to as the bank.

The forms used in the making of conditional sales were furnished by the bank to the partnership. In all conditional sales contracts purchasers agreed to pay the amount designated therein as the "Contract Balance," which is made up of the several items set forth in the example given below. The purchaser agreed to pay the amount of the contract balance in equal successive monthly installments at an office of the bank. The contracts provided that title to the car should remain in the dealer until all payments were made and all conditions of the contract were complied with. Two forms of assignment were used by the partnership in assigning the contracts to the bank. Under one form the assignment was made "with recourse" and the other was made "without recourse."

From January 7, 1950 to July 1, 1950 the part-

nership assigned contracts to the bank under the form which bore the caption "With Recourse" and from July 1950 until the end of the year it assigned contracts under the form designated "Without Recourse." Both forms of assignment during the year 1950 were made subject to an additional agreement between the partnership and the bank which contained the following provisions:

4. Evidence of registration showing the Bank as legal owner must accompany all contracts submitted for purchase.

\* \* \* \* \*

6. Notwithstanding the fact that the said contracts have been and will be assigned to Bank by Dealer without recourse, Dealer promises and agrees to repurchase from Bank contracts, including those executed or assigned on or subsequent to July 1st, 1950 on all such repossessed automobiles by paying Bank therefor the unpaid balance owing on such defaulted contracts, including all sums of principal, interest, charges due and to become due, and any and all collection and repossession costs, less a pro rata rebate of Bank's unearned charges. Dealer hereby waives the provisions of Section 2845, 2849 and 2850 of the Civil Code of the State of California.

\* \* \* \* \*

10. Bank may retain from the proceeds of each contract purchased hereunder, agreed upon amounts and the accumulated total of said amounts shall be retained by Bank in a Dealer Reserve Account as security for any and all obligations of

Dealer to Bank, now or hereafter existing. Bank agrees, so long as Dealer shall not be in default to Bank and remains solvent and in the automobile business, to return to Dealer every six months, upon request, any amount in said account in excess of 10% of the then aggregate unpaid balances of said contracts, provided that before any releases are made to the Dealer that a 100% reserve is set up for all repossessions, skips and past due accounts which are more than 35 days delinquent. If this agreement be terminated or Dealer discontinues the discounting of contracts, then Bank shall retain all funds in said Reserve Account until all contracts, purchased by Bank from Dealer shall have been paid in full, whereupon, the balance if any, shall then be paid to Dealer.

11. This Agreement may be terminated at any time by either party upon notice in writing to the other, provided, however, that such termination will not impair or effect the liability or obligations of Dealer to Bank under this Agreement on account of any contract purchased or transaction originated prior to the time such notice is given.

The bank did not give any consideration to the fair market value of any contract in purchasing it from the partnership. However, the credit of the purchaser of the automobile is checked by the bank and the sale of the car does not become final until the bank approves the credit.

The following example is typical, except for the amounts, of the conditional sales contracts entered

into between the partnership and the purchasers of used cars during the year 1950:

1. Cash Purchase Price .....	\$2,795.00
2. Sales Tax .....	83.85
3. Total Cash Purchase Price .....	2,878.85
4. Less: Down-payment .....	1,645.85
<hr/>	
5. Unpaid Cash Purchase Price .....	1,233.00
6. Add: Motor Vehicle Tax .....	40.00
<hr/>	
7. Unpaid Balance .....	1,273.00
8. Add: Time Price Differential .....	143.15
(Finance Charges or Interest)	
<hr/>	
9. Contract Balance .....	\$1,416.15

Upon assignment of a contract containing the figures in the example above set out the bank would immediately pay to the partnership the amount of \$1,233.00 shown as item 5 and designated "Unpaid Cash Purchase Price." Item 6 in the amount of \$40.00, representing motor vehicle tax, would be paid by the bank either to the partnership or directly to the Department of Motor Vehicles dependent upon whether the partnership or the bank cleared the title to the car. Item 8, designated as "Time Price Differential" consisted of finance charges or interest, and was variable depending upon what the partnership saw fit to charge the purchaser. At the time of assignment of contracts by the partnership the bank computed its discount at an agreed percentage of the "Contract Balance" which, in the above example, is \$1,416.15. The rate of discount used in 1950 was 4 percent per year. In the above example the discount would amount

to \$70.90 inasmuch as the contract was to run for a period of 15 months. In addition to the discount the bank made a flat charge of \$5 on each assigned contract. The bank treated the \$5 as earned discount and the \$70.90 as unearned discount. The remainder of the contract balance not paid over in cash to the dealer would be credited to the dealer's reserve account provided for in the above-quoted agreement. In the example the difference between \$75.90, representing the bank's discount, and the \$143.15, representing the "Time Price Differential," namely \$67.25, is the amount which would be so credited.

The entries in the dealer's reserve account on the books of the bank were recorded by the partnership in a memorandum account. The partnership did not record such entries in a general ledger account nor did it reflect them in any of its financial statements. The bank informed the partnership of entries made in the reserve account and periodically sent the partnership statements showing the balance in such account.

Purposes of the bank in maintaining the dealer's reserve account were to provide security for the payment of the assigned contracts and to induce the dealer to discount contracts with it. The dealer's purpose in entering into the arrangement with the bank was to secure necessary financing for its operations.

During the year 1950 some of the purchasers under contracts which the partnership had assigned



to the bank paid off the contracts prior to their normal maturity dates and accordingly under applicable state law <sup>1</sup> were not obligated to pay the entire

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<sup>1</sup> Section 2982 of the California Civil Code (West's Annotated California Codes, vol. 11) provides in part as follows:

(c) Time price differential; limit. The amount of the time price differential in any conditional sale contract for the sale of a motor vehicle, with or without accessories, shall not exceed 1 percent of the unpaid balance multiplied by the number of months, including any excess fraction thereof as one month, elapsing between the date of such contract and the due date of the last installment, or twenty-five dollars (\$25), whichever is greater, provided that such contract may provide for interest on any delinquent installment from and after the date of delinquency, and for reasonable collection costs and fees in the event of delinquency.

(d) Payment before maturity; refund credit. Any provision in any conditional sale contract for the sale of a motor vehicle to the contrary notwithstanding, the buyer may satisfy in full the indebtedness evidenced by such contract at any time before the final maturity thereof, and in so satisfying such indebtedness shall receive a refund credit thereon for such anticipation of payments. The amount of such refund shall represent at least as great a proportion of the time price differential, after first deducting from such time price differential a minimum charge of not to exceed twenty-five dollars (\$25), as the sum of the periodic time balances after the month in which such contract is paid in full bears to the sum of all of the periodic time balances under the schedule of payments in the contract, both sums to be determined according to the monthly balances which would result if the indebtedness were paid according to the terms of the contract; provided, however, that the provisions of this subsection shall not impair the right of the seller or his assignee to receive a minimum

sum designated "Time Price Differential," but only a lesser sum. In these circumstances, the bank debited the reserve account for the portion of the sum that was no longer due from the purchaser.

In the above example of a 15-month contract, if the purchaser paid up the contract in six months, the bank would reduce the amount of the time price differential by the sum of \$44.20 of which \$22.83 would be entered in its unearned discount account and \$21.37 would be charged to the dealer's reserve account.

The following schedule sets forth, with respect to some of the contracts assigned by the partnership to the bank, the date and amount of the original credits by the bank to the reserve account, and the dates and amounts of the debits to such account in instances of prepayments by the purchasers of cars:

Credits to  
Reserve Account

Debits to  
Reserve Account

Date	Amount	Date	Amount
1/21/50	\$ 29.90	2/17/50	\$ 19.90
3/27/50	15.40	6/ 3/50	2.20
6/ 1/50	106.00	6/15/50	88.32
5/27/50	49.35	7/20/50	30.00
6/20/50	52.24	6/29/50	52.24
4/14/50	84.21	8/10/50	56.01
7/14/50	50.80	8/16/50	37.53
8/ 2/50	107.57	8/18/50	94.37
8/ 4/50	211.55	8/29/50	153.40

time price differential of twenty-five dollars (\$25), or to receive interest on delinquent installments or reasonable collection costs and fees, as provided in subsection (c) of this section; and provided further, that where the amount of such refund credit would be less than one dollar (\$1), no refund need be made.

The above schedule is merely illustrative and does not set forth all instances where prepayments were made by purchasers.

In determining whether a dealer was entitled to withdraw any amount from the reserve account the bank deducted from the amount of the reserve the full amount of the partnership's recourse liability on any delinquent accounts and repossessions. During the year 1950 the credit balance in the reserve account of the Art Morgan Motor Company, reduced on account of delinquencies and repossessions, never exceeded 10 per cent of the aggregate unpaid balances of the contracts that had been assigned by the partnership to the bank. The partnership was not entitled to receive and the bank was not required to make, and did not make, any payments to the partnership in pursuance of the terms of the agreement in paragraph 10 of the agreement above quoted. At all times material the bank was financially sound and was able to pay any amount due to the partnership.

During the taxable year the credits to the reserve account totaled \$16,895.08, and the debits thereto totaled \$1,130.76, leaving a credit balance of \$15,764.32 at the end of the year.

The partnership did not report as income for the period in question any of the credits to the reserve account or any of the \$15,764.32 credit balance therein; nor did it report any of the debts as a deduction. The partnership did not claim a bad debt deduction for the taxable year in question.

In determining the deficiency, the respondent in-

creased the partnership's income for the taxable year 1950 by the sum of \$15,764.32, representing the credit balance in the reserve account as of the end of the taxable period 1950, and as a consequence increased the petitioner's distributive share of the income of the partnership. The respondent also held that the \$15,764.32 item did not constitute a deductible item to the partnership under any provision of the Internal Revenue Code of 1939.

### Opinion

The sole question presented is whether the amount of the credit balance in the dealer's reserve account on the books of the bank at the end of the taxable period constituted gross income to the dealer partnership in that period.

When the partnership sold an automobile under a conditional sales contract, the purchaser obligated himself to pay in installments over a specified time a contract balance which included not only the selling price of the car (after deducting the down payment) but a time price differential composed of finance charges or interest. The partnership then assigned to the bank all its right, title and interest in the contract, including its security interest in the automobile. The bank immediately paid the partnership an amount equal to the remaining unpaid purchase price of the car and credited the remainder of the contract balance, after subtracting its discount (which consisted of a flat charge and a percentage of the contract balance), to the dealer's reserve account. The partnership, in consid-



eration of such credit, guaranteed full performance of the sales contract. It would become liable as guarantor in the case of any defaults. In the case of any repossessions by the bank, the bank was to deliver the repossessed cars to the partnership and the partnership agreed to repurchase the contracts on all such repossessed automobiles by paying the bank the unpaid balance owing on the defaulted contracts, including all sums of principal, interest, charges due and to become due, less a pro rata rebate of the bank's unearned charges.

The partnership had the right to receive, every six months, upon its request, any amount in the reserve account in excess of ten percent of the then aggregate unpaid balance of contracts. Upon termination of the agreement between the partnership and the bank, the partnership was entitled to receive the amount of the reserve at such time as all contracts were paid in full.

The respondent has determined that the total credit balance in the dealer's reserve account as of the end of the taxable period constituted income to the partnership. This was the partnership's first taxable period and the total amount of the reserve at the end of the period therefore represented the net addition thereto. Under similar circumstances we have held, in a number of cases involving taxpayers who maintain their books and return their income on an accrual method of accounting, that this treatment is correct. *Shoemaker-Nash, Inc.*, 41 B.T.A. 417; *Albert M. Brodsky*, 27 T.C. 216; *Texas Trailercoach, Inc.*, 27 T.C. 575 (now on appeal



C.A. 5); and *West Pontiac, Inc.*, 27 T.C. 749 (now on appeal C.A. 5).

The petitioners contend that our prior cases were not correctly decided, but alternatively contend that the instant case is factually distinguishable from such prior cases. They contend that there was not an unqualified obligation on the part of the bank to pay the partnership the full amount credited to the dealer's reserve, since, under the law of California, the purchaser of an automobile has a right, upon the satisfaction of his contract prior to maturity, to a rebate (or to be relieved of payment) of a portion of the time price differential, in which case a debit is made to the dealer's reserve account of a proportionate part of such time price differential. They claim that the credit is nothing more than a book-keeping entry of an amount which may at some time become payable, that it is a mere potential liability (apparently of the bank), and that since the amount payable has not become fixed it is not properly accruable. They also contend, apparently alternatively, that the arrangement between the partnership and the bank is in the nature of a joint venture in which the parties are to share the time price differential when "earned."

The agreement between the partnership and the bank does not specifically deal with the liabilities of the parties in the event of the satisfaction of a purchaser's liability prior to maturity of his obligation, but the testimony is that in such a case the reserve is debited in the amount of a portion of the time price differential.

We see no essential difference between this case and those which we have previously decided. Here, as in such previous cases, the reserve was designed to protect the finance company and the amount therein at any particular time could redound to the partnership's benefit through discharge of its guaranty obligations to the bank. Here also the amount of the reserve in excess of a percentage of the aggregate unpaid contract balances is payable to the partnership and the partnership is entitled to the entire balance in the reserve if and when all the contracts are paid in full. Under these circumstances, we think the partnership's right to receive the net amount of the addition to the reserve during the taxable period became fixed, requiring its accrual by the partnership, under the principle of *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182. The case of *Albert M. Brodsky, supra*, is closely in point, since there the dealer's reserve was made up of credits representing the difference between the bank's discount rate and the "contract carrying charge," which in this case is called the "time price differential."

We do not agree with the petitioners that the arrangement between the partnership and the bank was in the nature of a joint venture in which each was to share in the time price differential as it was "earned." Actually the bank was making a specific charge and its income from the transaction was limited to that amount. As we view the relationship between the partnership and the bank, the bank undertook an obligation to satisfy the full amount

of the contract balance, less its discount consisting of its specific charge and a percentage of the total contract balance. It satisfied that obligation by payment immediately of the remaining unpaid selling price of the car in cash to the partnership and by setting up a reserve for the balance. The amounts credited to the reserve were payable to or on behalf of the partnership in the manner described above. The obligation of the bank to the partnership was an accrued liability at that time. The mere fact that payment of the portion that went into the reserve account was postponed does not affect its accruability in the year in which the credit was made. And the possibility that subsequent prepayments by purchasers of cars would reduce the amount in the reserve does not affect the accruability since such reduction would be the consequence of a condition subsequent.

The petitioners contend that if the respondent's determination is approved the result is that they will be taxed on income which they may never receive. However, since the reserve as of the end of the taxable period has been reduced on account of prepayments of contracts during the period, it is clear that insofar as those contracts are concerned the petitioners will not be taxed on income which they will never receive. Furthermore, if any of the other contracts are prepaid during the next taxable year, debits on account thereof will serve to offset otherwise taxable income represented by credits to the reserve account.

If the partnership sustains losses on account of

its guaranty of contracts, the question then becomes one of deduction which is not involved in this proceeding. *Spring City Foundry Co. v. Commissioner*, *supra*.

The petitioners rely upon *Johnson v. Commissioner* (C. A. 4), 233 F. 2d 952, which reversed our decision in *Blaine Johnson*, 25 T.C. 123. However, here, as in our previous cases cited above, with due deference to the Court of Appeals for the Fourth Circuit, we feel compelled to adhere to our previous decisions.

Decision will be entered for the respondent.

Served and Entered Oct. 18, 1957.

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Tax Court of the United States  
Washington

Docket No. 56621

ARTHUR V. MORGAN and DOROTHY O.  
MORGAN, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed October 17, 1957, it is

Ordered and Decided: That there is a deficiency

in income tax for the calendar year 1950 in the amount of \$4,076.40.

Entered Oct. 17, 1957.

[Seal]      /s/ CRAIG S. ATKINS,  
Judge.

Served and Entered Oct. 21, 1957.

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[Title of Tax Court and Cause.]

## PETITION FOR REVIEW OF DECISION OF TAX COURT

Comes now petitioners Arthur V. Morgan and Dorothy O. Morgan, and respectfully petitions for a review of the decision of the Tax Court rendered in the above entitled matter, and respectfully alleges:

### I.

The above entitled proceeding involves the petitioners' income taxes for the year 1950.

The controversy relates primarily to the question of whether amounts credited to a dealer's reserve account by the finance company acquiring conditional sales contracts covering the sale of automobiles by assignment with recourse from taxpayer, an accrual basis automobile dealer, and which credits were subject to reduction pursuant to state law when a contract was paid off prior to maturity and also subject to reduction for repossession losses and where such credits were not an absolute liability of the finance company to the dealer and where the



dealer had no present right to receive money from the bank equal to these credits, or to receive any amount of money as a result of these credits during the taxable year in question, taxable as income to him in the years in which the contracts are assigned to the finance company or in the year in which these credits, if any, become payable to him under the terms of the agreement between taxpayer and the finance company.

It was the decision of the Tax Court herein that these credits to the dealer's reserve account on the books of the finance company that purchased the conditional sales contract were accruable as income to the dealer in the year of the sale of the contracts even though the amount of the reserve at the close of the year was not sufficient to allow the dealer to demand payment of any part thereof. It is the contention of the petitioners that these credits to the reserve account which represent a portion of the unearned interest are not income to the petitioners until there is some payment due petitioners under the terms of the agreement between the dealer and the finance company.

## II.

The review is sought before the United States Circuit Court of Appeals for the Ninth Circuit.

## III.

The petitioners at all times herein mentioned have resided and now reside in the County of Los Angeles, State of California; that they filed their income tax return for the year involved with the

Collector of Internal Revenue at Los Angeles, Sixth District of California.

That the place where petitioner resides, and the place where the office of said Collector (now Director) of Internal Revenue at Los Angeles is located is within the Circuit of the United States Court of Appeals for the Ninth Circuit, and said Court is the Court having jurisdiction of a review of the decision of the Tax Court herein under the provisions of Internal Revenue Code, Section 7482.

That the decision of the Tax Court was entered herein on October 17, 1957; that the time for filing a Petition for Review will expire January 17, 1958 (IRC 7483).

Wherefore, your petitioners pray that a review be had of the decision of the Tax Court rendered in the above entitled matter, and that upon such review said decision be reversed.

Respectfully submitted,

/s/ LEONARD B. HANKINS,  
Attorney for Petitioners.

Affidavit of Mailing Attached.

[Endorsed]: T.C.U.S. Filed Jan. 7, 1958.

[Title of Tax Court and Cause.]

NOTICE OF FILING OF PETITION  
FOR REVIEW

To: Nelson P. Rose, Chief Counsel, Internal Revenue Service:

You are hereby notified that on January 3, 1958, Arthur V. Morgan, and Dorothy O. Morgan, the petitioners herein, filed a Petition for Review of the Decision of the Tax Court heretofore rendered herein. There is delivered to you herewith a copy of the Petition filed.

Dated: January 3, 1958.

/s/ LEONARD B. HANKINS,  
Attorney for Petitioners.

Acknowledgment of Service Attached.

[Endorsed]: T.C.U.S. Filed Jan. 7, 1958.

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[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 19, inclusive, constitute and are all of the original papers on file in my office as called for by the "Designation of Contents of Record on Review", including Joint exhibits 1-A thru 6-F, attached to the Stipulation of Facts, in the case before the Tax Court of the United States

docketed at the above number and in which the petitioners in the Tax Court have filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of January, 1958.

[Seal]      /s/ HOWARD P. LOCKE,  
                         Clerk, Tax Court of the  
                         United States.

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In the Tax Court of the United States

Docket No. 56621

ARTHUR V. MORGAN, et al.,      Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## TRANSCRIPT OF PROCEEDINGS

Federal Building, Los Angeles, California, Friday, January 11, 1957.

The above-entitled matter came on for hearing, pursuant to notice, at 10:45 o'clock a.m.

Before: Honorable Craig S. Atkins.

Appearances: Leonard B. Hankins, Esq., appear-

ing on behalf of Petitioners. Joseph G. White, appearing on behalf of Respondent. [1]\*

### Proceedings

The Clerk: Docket No. 56621, Arthur V. Morgan. State your appearances, please, gentlemen.

Mr. Hankins: Leonard B. Hankins, for the Petitioner.

Mr. White: Joseph White, for the Respondent. Ready for trial.

Mr. Hankins: Ready for trial.

The Court: Mr. Hankins, do you have an opening statement?

Mr. Hankins: Yes, sir.

### Opening Statement on Behalf of Petitioners

Mr. Hankins: Your Honor, this is an income tax case in which a single and familiar issue is presented. This issue is whether the portion of the finance charges which were unearned and credited by the Farmers & Merchants Bank of Long Beach, California, to whom conditional sales contracts were transferred by the Art Morgan Motor Company, a partnership, was income to the partnership in the year during which these charges were credited to the dealer's finance reserve by the bank or was the income from this, if any, to be included in the year in which the sum became payable to the partnership, pursuant to terms agreeable between the bank and the partnership.

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\* Page numbers appearing at top of page of Reporter's Transcript of Record.



Most of the facts will be stipulated between [3] Petitioners and Respondent. Arthur V. Morgan, the petitioner here and Frank D. Lortscher formed a partnership doing business as Art Morgan Motor Company in Long Beach, California, on January 7th, 1950.

The petitioner held a 75 per cent interest and Frank Lortscher held a 25 per cent interest throughout the taxable period in question.

The partnership was actively engaged in the purchase and retail sales of used automobiles. The partnership's books and records were maintained on the accrual basis of accounting.

A large number of automobiles sold on conditional sales contracts, and in order to finance these sales, the partnership assigned the contracts to the Farmers & Merchants Bank of Long Beach, California.

From January 7, 1950, to July 1, 1950, the partnership assigned the contracts to the bank pursuant to both the terms of the assignment on the bank of the conditional sales contracts under the caption "without recourse," and pursuant to certain terms of an oral agreement between the partnership and the bank.

From July and throughout the remainder of the taxable period in question, the partnership assigned two partnership contracts to the bank pursuant to terms on the reverse side of the conditional sales contract under the [4] caption "without recourse," and pursuant to the terms of a written agreement which will be stipulated in evidence.

When a conditional sales contract was assigned to the bank, the bank would in most cases pay to the dealer the unpaid cash purchase price of the automobile. In other cases, if the unpaid cash price was in excess of the amount of which the bank would normally loan on the automobile, the bank would withhold the balance of the unpaid purchase price over the amount the bank would loan on the automobile. This withhold would be placed in account security by the bank and would be released by the bank when the contract was paid down a sufficient amount which the bank deemed necessary for security. The bank then split up the finance charges on its books, a portion of which was credited to the bank under "earned discount."

Another portion credited to a special reserve for losses, and the remaining portion of the reserve was credited to the Art Morgan dealers finance reserve account. The portion credited to the dealers finance reserve account was not subject to withdrawal by the dealers, but instead there were other computations made by the bank in order to determine what portion, if any, the dealer was entitled to have paid to him, any money represented by the dealers finance reserve account. Ultimate payment by the bank of any of these dealers finance reserves was in consideration [5] for the dealers guaranteeing the paper, the computations in order to determine the amount available and payable to the dealer every six months was in essence as follows:—

The Court: May I interrupt you a moment, sir?  
I want to speak to counsel off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Hankins: The bank would compute the account and credit to the dealer's finance reserve account that portion of the finance charge of each contract which it added to the dealer's finance reserve and subtracted all deductions to this reserve account because of pay-offs of the conditional sales contract prior to maturity date by which the bank was obligated under California law to reduce the total amount of the finance charges collectible.

To this remaining balance of the dealers finance reserve account was then subtracted the balance of each contract which was past due for more than thirty-five days. The bank then computed the unpaid balances of all conditional sales contracts assigned by the dealer to the bank and if 10 per cent of these unpaid balances was less than the sum total of the dealer's finance reserve as adjusted above, then that balance was due and payable to the dealer. If the 10 per cent was greater, then nothing was payable to the dealer.

The portion of the finance charges which was [6] originally allocated to the dealer's finance reserve account is always subject to readjustment, and reductions therein accordingly reduced where conditional sales contracts were paid off prior to their maturity date. This adjustment for reduction in finance charges were made pursuant to the provisions of California law.

When the original finance charge was computed, reduced as computed, is reduced to the automobile purchaser a portion of the reduction used to decrease the bank's portion of its unearned discount and the remainder used to reduce the dealer portion of the reserve account during the taxable period in question.

The credits to the Art Morgan dealer's finance reserve account totaled \$16,895.08; reductions totaled \$1,130.76, leaving a credit balance of \$15,764.32.

During the taxable year in question, the credit balance of the reserve account never exceeded 10 per cent of this unpaid balance of the contracts assigned by the partnership to the bank and the bank was not required to do, and did not make any payment to the partnership pursuant to the terms of their agreement.

The partnership did not report as taxable income for the period in question any of their credits to the reserve account or any of the balance in the reserve account remaining after certain reductions in the account were made [7] by the bank, nor did the partnership report any reduction in the reserve account in its income tax return.

The applicable State law which requires a deduction of total finance charges originally appearing on conditional sales contracts is Section 2892 of the California Civil Code.

This concludes the petitioner's opening statement, your Honor.

## Opening Statement on Behalf of the Respondent

Mr. White: In the beginning, your Honor, I would like to state that the assignment of the contracts from the period January 7, 1950, to July 1, 1950, was subject to the assignment in Exhibit 1-A, entitled "with recourse," and also subject to oral agreement which incorporated Paragraph 10 of Exhibit 2-B. I think counsel for the petitioner inadvertently stated it was an assignment labeled "without recourse."

As stated by counsel for the petitioner, this is a rather old and frequently occurring issue, the question of whether these credits to a dealer's finance reserve are income to the dealer—by dealer, we mean the automobile dealer at the time the bank credits this account—or whether the dealer, even though he is on the accrual basis, can wait until the bank makes a cash payment to him before reporting this as income. [8]

The Tax Court has held in favor of the respondent that it is taxable income to the dealer on accrual basis at the time the credit is made to the account.

There is a long line of cases in that regard, first of all the Blaine Johnson case which was 25 TC 123—

Mr. Hankins: Your Honor, I object. This seems to be argument which should be in brief rather than facts in the case.

Mr. White: I am doing this, your Honor, to help you follow the testimony which will come. I am not attempting to argue, but I do want the Court to



know what the picture is. I am not going into controversy except to state that they exist.

With your permission, the Blaine Johnson case is one where the Tax Court held for the Respondent and the Fourth Circuit reversed and held for the taxpayer.

In addition to the Blaine Johnson case, there have been numerous cases in the Tax Court, one of which is the Albert M. Brodsky case, a recent case in 27 TC, which again held for the Government, calling attention to the Fourth Circuit as to that previous opinion, this position was again taken by the Tax Court.

To help your Honor follow the testimony which we will have this morning, I will first submit, with permission of counsel, the stipulation of facts together with exhibits [9] attached. I might add that there are three exhibits not yet attached. They are income tax returns we haven't had time to photostat. We will do that as quickly as we can and mail them to Washington.

The Court: Very well. The stipulation will be received.

Mr. White: I think it will help your Honor if you would turn to Paragraph 10 of that stipulation and at that point you will see a paragraph which is in controversy this morning and there will be some terminology there which will be used often this morning and which we might as well acquaint ourselves with at the moment.

Paragraph 10 sets forth as a typical example, a section of the conditional sales contract employed

by this partnership, the Art Morgan Motor Company.

The Court: Paragraph 10?

Mr. White: Paragraph 10 on page 3 of the stipulation. You will notice, your Honor, the first item is "cash purchase price." There is added to that the sales tax and then the total is shown below that. Item 4 is the down payment. That down payment is subtracted from Item 3 and we have the unpaid cash purchase price. To that is added the motor vehicle tax, another total is brought down. Now, at this point we have reached one item which will be discussed often this morning, that is the unpaid balance which is Item [10] No. 7.

In this example is \$1,273.00.

The next item which will be spoken of often is Item No. 8, referred to as "time price differential," which is another term for finance charge of the interest which the purchaser agrees to pay on this conditional sales contract.

The items prior thereto would be the cost of the automobile, the insurance and the taxes, such as the Motor Vehicle tax, but at this point we reach for the first time the finance charge or interest which he agrees to pay.

The Court: Now, is that the profit that the company makes out of this?

Mr. White: That will be the interest. It is not the profit that the dealer makes.

The Court: What is the name of the bank?

Mr. White: Merchants—Farmers & Merchants Bank.

The Court: Farmers & Merchants Bank. Now, as I understand these notes—are these discounted or not?

Mr. White: We will reach that in a moment.

The Court: But, in any event, that interest represents a part of the income of the bank?

Mr. White: The bank will earn a part of that. I think I had better go on to explain at this point the contract is between the purchaser of the automobile and the dealer. The bank hasn't entered at this point. The dealer and the purchaser execute this conditional sales contract, which contains [11] these terms and, as I say, Item 7 is the unpaid balance to which is added the finance charge or interest called herein "time price differential."

Another total is drawn and we have a contract balance that, again, is a crucial item in the testimony this morning. The dealer, then, takes this conditional sales contract to the bank—and whenever we refer to "bank" here, we mean the Farmers & Merchants Bank of Long Beach—where this contract is discounted by the bank, for example, the bank will discount at the rate of four and a half per cent for \$100.00 in the contract balance. In that contract balance the bank will pay four and a half per cent as its discount.

I think that answers your question, your Honor, at this point, the bank takes out, so to speak, what it intends to earn on this contract.

The Court: That is four and a half per cent of what figure?

Mr. White: Roughly—let's say the contract bal-

ance. In addition to that — and here is a crucial credit question — let me correct myself. After deducting the discount from this contract balance which is the last item, No. 9, you will have a sum, for example it might be a thousand dollars. The bank does not pay the \$1,000 in cash to the dealer, it withholds from that \$1,000 a certain sum which we [12] refer to here as the dealer's finance reserve credit. That particular sum the bank credits to this account which has various names, I think here we call it the reserve account, and as explained by the petitioner's counsel, as the credit balance in that reserve account reaches a certain level the bank will then pay in cash to the dealer a certain sum depending on the sum that is left in the reserve account.

Now, here is where we reach argument. The petitioner's contention is: When the bank is crediting to this reserve a portion of Item No. 8 which refers to finance charge or time price differential, the Government contends that the bank credits to the reserve a portion of the contract balance and that it is a relatively insignificant with the time price differential. The bank is going to credit a certain amount to that reserve regardless of how much the time price differential is.

At this point we reach argument, and testimony will be taken this morning from the bank and I believe also from the petitioner, Mr. Morgan, to determine what was the procedure in the year in question.

I might add, while talking about the year in

question, that the partnership period here is January 7, 1950, to December 31, 1950. The taxpayer's year is a calendar year, 1950, so his income in question is for the partnership period ending December 31, 1950. It falls in that same year, [13] the taxpayers, husband and wife.

I might add also to this point, again to clarify, that the reserve account which the bank sets up on its books is, in the opinion of the respondent, security, so that in case there is a default on some contract which the bank has purchased from the dealer and the dealer cannot make good its guarantee to the bank, the bank has this reserve which it can resort to as security; in such an instance the bank would debit that reserve or perhaps first seek direct payment from the dealer, and I suppose it would prefer direct payment so that the reserve would be kept at the high level.

A second instance in which that reserve might be debited is where a purchaser on this contract pays off the contract prior to that—prior to the maturity. Under State law, he is not required to pay that entire finance charge or time price differential, he pays a lesser sum. There will then be, in that instance, a lesser sum to be collected by the bank because of reduction in the finance charges. The bank will then debit the dealer's reserve, but it is for the entire amount or a portion, which will be brought out in testimony.

And then another, a third method in which that account is debited is if the credit balance reaches a



certain level where the bank is obliged to and does make a cash payment to the dealer. [14]

In some of the cases which have come before the Tax Court, the respondent has placed in income of the dealer the credits to this reserve and allowed a reduction for the appropriate debits. In the instant case, the respondent has, instead of placing all credit in income, it has merely placed the credit balance at the end of the year in the income from the dealer in the instant case. That credit balance is approximately \$15,000.

In similar cases an issue of the deduction for bad debt has been injected. We need not reach it in this case, insofar as no deduction for bad debt was, for the taxable period in question, made for the partnership.

Your Honor, that concludes the respondent's opening statement.

The Court: Very well.

Mr. Hankins: The petitioner would like to call for its first witness Mr. Russell H. Simpson.

#### RUSSELL H. SIMPSON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Be seated, please, and state your full name.

The Witness: Russell H. Simpson. [15]

#### Direct Examination

Q. (By Mr. Hankins): Mr. Simpson, what is your present occupation?

(Testimony of Russell H. Simpson.)

A. I am assistant cashier with the Farmers & Merchants Bank.

Q. How long have you been with the Farmers & Merchants Bank?      A. Twelve years.

Q. You were with the Farmers & Merchants Bank, then, in 1950?      A. Right.

Q. Prior to that time?      A. Yes.

Q. Do you know the procedures used by the bank in purchasing conditional sales contracts from used car dealers?      A. I do.

Q. Was the procedure used in purchasing these conditional sales contracts from used car dealers the same for all dealers who had conditional sales contracts assigned to the bank?      A. Yes.

Q. Were you acquainted with the operations of Mr.—strike that.

Are you acquainted with the Art Morgan Motor Company partnership? [16]      A. Yes.

Q. And did the Art Morgan Motor Company assign any conditional sales contracts to the Farmers & Merchants Bank in 1950?

A. Yes, they did.

Q. Does the bank still have any of the copies of conditional sales contracts which were assigned by the Art Morgan Motor Company to the Farmers & Merchants Bank during the year 1950?

A. No, they do not.

Q. What generally does the bank do with those conditional sales contracts?

A. We have only one copy and that is the orig-

(Testimony of Russell H. Simpson.)

inal. When the account is paid out, the original is returned to the purchaser.

Q. Then, you don't have any of those records?

A. Only the ledger card which would recite the obligation of the contract.

Mr. Hankins: We have stipulated in evidence the conditional sales contract, and I would like to call that to the attention of the witness.

Q. Mr. Simpson, I direct your attention to this conditional sales contract, which has been stipulated in evidence as Exhibit 1-A, and I would also like to direct your attention to Paragraph 10, showing a typical transaction [17] setting forth sums which might appear on a conditional sales contract.

The Court: That is in the stipulation of facts?

Mr. Hankins: Yes, sir.

Q. (By Mr. Hankins): Directing your attention to the—to both of those exhibits, when a contract written on a conditional sales contract, such as Exhibit 1-A thereon of which the sums set forth in the stipulation of fact in Paragraph 10 appear and this contract covered the sale of used cars by Art Morgan Motor Company, and this contract was assigned by the Art Morgan Motor Company to the Farmers & Merchants Bank: Can you state how much money was paid on that contract to the Art Morgan Motor Company at the time the contract was assigned to the bank? A. Yes.

Q. Would you state that amount, please?

A. \$1233.

Q. Now I will direct your attention to Para-

(Testimony of Russell H. Simpson.)

graph 10, line 8, and assuming the same factual situation that I gave you previously, under the two documents and the same figures appearing on both, could you state how much or how the bank handled the \$143.15?      A. Yes.

Q. Would you describe the procedures used by the bank [18] in handling that amount?

A. We would arrive at a charge determined by the rate that we were charging the dealer and would take that charge and subtract it from the time price differential here on line 7—on line 8, and credit the balance to the dealer's reserve account.

Q. Have you made a breakdown of these figures, the computations that the bank makes, for this \$143.15?      A. Yes, I have.

Q. What is the breakdown that you have computed?

A. The bank charges would be \$75.90 and there would be credited to the dealer's account \$67.25, to the dealer's reserve account.

The Court: Would that be the total charge that you would be making on this whole transaction?

The Witness: For the bank charges?

The Court: The bank charges would be that figure you just gave?

The Witness: That is correct, seventy-five ninety. That would be the total charge.

Mr. White: And the portion to the dealer was how much?

The Witness: \$67.25.

(Testimony of Russell H. Simpson.)

Q. (By Mr. Hankins): Then, Mr. Simpson, I believe in taking your time [19] price differential, that you stated the bank would then make these allocations on its book, seventy-five ninety to the bank's share and the dealer's share \$67.25 of the \$143.15? A. Correct.

Q. Now, to what account in the bank is this credited?

A. Seventy dollars and ninety cents would be charged to unearned discount.

Q. Seventy dollars and ninety cents?

A. Right, five dollars would be charged to earned discount.

Q. And the dealer's share, what account was that charged to?

A. Deposited to the Art Morgan Motor Company's reserve account.

The Court: That would be credit, wouldn't it?

The Witness: Credit, that's right.

Q. (By Mr. Hankins): In other words, the \$143.15 was split up, \$70.90 to the bank under unearned discount, \$5.00 to the bank as earned discount, and \$67.25 to the dealer's finance reserve account; is that right? A. That's right.

Q. Were any of these contracts paid off prior to maturity? A. Yes. [20]

Q. About what length of time, generally, were contracts paid off?

A. Any time during the life of the contract.

Q. Any time during the life of the contract.



(Testimony of Russell H. Simpson.)

Could this contract have been paid off after six payments?      A. Yes.

Q. If this contract had been paid off after six payments, would the bank make any adjustments in its records?      A. Yes.

Q. What, generally, would the bank do then if it was paid off in five months, which is prior to the maturity of the contract, say, running fifteen months?

A. We would refund the unearned portion of the time sales markup.

Q. Assuming that this contract was a fifteen-month contract and it was paid off in six months, have you made any computations to show what adjustments the bank would have made to its records?

A. Yes, I have.

Q. What are those?

A. There would be a refund of unearned charges in the amount of \$44.20.

Q. \$44.20. That would be a reduction in this time price differential?      A. Correct. [21]

Q. What else does the bank do?

A. Since the bank has refunded charges it had previously collected, they can split up that refund between that portion of the refund that the bank would charge itself and that portion that they would charge to the dealer's reserve account.

Q. Have you made the computations of what figures would be represented?

A. Yes. In this particular case, \$21.37 would

(Testimony of Russell H. Simpson.)

have been charged to the dealer's reserve account and \$22.83 to the bank unearned discount.

Q. Then, in essence, if this contract is paid off prior to its maturity date, then you would make a reduction to the purchaser of \$44.20?

A. That's right.

Q. You would then lose of the original unearned discount of \$70.90, you would lose \$22.83, the bank would? A. That's right.

The Court: That means you would have earned that much less than you originally thought you would earn?

The Witness: Right.

Q. (By Mr. Hankins): Then the dealer would lose, or his earnings would be \$21.37 less than the original share? A. That's right. [22]

Q. Now, Mr. Simpson, in handling these contracts at the bank, the dealer brings them in to you and you split up these reserves in this manner, as you have pointed out here. Would you ever take more of this contract for your unearned discount than is shown on the time price differential line of the contract?

A. That would not be possible.

Q. It wouldn't be possible? A. No.

Q. In other words, the dealer, then, would always have some share of this time price differential? A. That's right.

Q. Is this \$67.25 that you put over into this dealer's reserve account, is that subject to the dealer's withdrawal immediately?

(Testimony of Russell H. Simpson.)

A. The dealer has no control over that account whatever.

Q. Well, the dealer—the dealer ultimately gets the full \$67.25?

A. It is possible for him to get that \$67.25, but you would never be able to tie it down to any one payment.

The Court: Isn't it true that if the contract went on to maturity and it was paid regularly, that in effect the dealer would get that in a particular case?

The Witness: It's possible, except I think it would [23] be more proper to say, the question being asked by counsel, that is equity in his reserve account.

The Court: In other words, what you are saying is: He doesn't get a specific amount from specific contracts, it is a matter of reserve, but my point was that if all contracts went on to maturity, certainly the fact is that in every case he would eventually get that amount?

The Witness: All paid out at maturity and not before.

Q. (By Mr. Hankins): In essence, then, you take your time price differential and the dealer and bank shares in that? A. That's right.

Q. The \$67.25 that you originally put over there, is that represented by cash?

A. No, that is merely a book entry.

Q. Merely a book entry? A. That's right.

Q. Then, in order to allow the dealer to with-

(Testimony of Russell H. Simpson.)

draw anything under his contract, what subsequent computations does the bank make in order to determine what, if anything, is payable to the dealer out of an account in which these items are accumulated?

A. The bank predetermines a percentage of the dealer's contingent liability, that is to say, if all the [24] dealer's contracts totaled a million dollars, the bank would want a 10 per cent reserve. The bank would refund to the dealer anything in excess of that 10 per cent reserve after deducting from the reserve all those accounts which had more than one payment past due or unpaid repossession.

Q. In other words, this original \$67.25 of the time price differential which you put into the dealer's finance reserve account is subject to other computations before you can determine what, if any, portion of this is due the dealer; is that right?

A. Correct.

Q. It is subject to any reductions of pay-offs?

A. Right.

Q. Writing the balance down in the credit side of the dealer's reserve account by each debit to the account as a result of pay-offs? A. Right.

Q. Then, assuming that our dealer's reserve account at the end of the year was \$15,764.32, then if this figure, plus your balance of the contracts on which more than one payment is past due, is in excess of the 10 per cent of this outstanding contract balances, then would you pay him any money?

(Testimony of Russell H. Simpson.)

A. May I answer that with an explanation, rather?

Actually, what we do is: We would take 100 per [25] cent reserve on all delinquent accounts, plus 100 per cent reserve on all unpaid repossessions, and subtract it from the amount of the reserve, so if we raised that figure of \$10,000, for example, say that \$10,000 figure——

The Court: What \$10,000 figure?

The Witness: Let's say that is his dealer's reserve.

The Court: That's 10 per cent of the contract balance?

The Witness: Correct. Let's raise that. Let's say he has a contingent liability and has 10 per cent reserve of \$10,000——

Mr. White: 10 per cent would be a hundred thousand.

The Witness: A hundred thousand. Let's raise that hundred thousand to a hundred and five thousand for the purpose of——

The Court: You raise that to a hundred and five thousand?

The Witness: He has built up an equity in his reserve and finally got five thousand above his 10 per cent——

Q. (By Mr. Hankins): 10 per cent is——

A. He has 5 per cent. Ordinarily that would be available to him from his reserve account, except for the fact that—let's say we have \$6,000 worth of delinquent [26] accounts and another \$3,000



(Testimony of Russell H. Simpson.)

worth of repossessions, that would be \$8,000. That would reduce his reserve down to \$97,000 and he wouldn't be able to withdraw any of his reserve.

The Court: I am a little confused here. I followed you very well to this point. As I understand it, in the example, \$15,764.32 is a sum to be credit balance in the dealer's reserve?

The Witness: Right.

The Court: Now, am I correct in my assumption that if that figure at a particular date—what is it, at the end of the year or periodic?

The Witness: Any date.

The Court: On any date the dealer wants to withdraw—draw down whatever he made, he is permitted to draw down the excess of that amount represented in this case by the fifteen-thousand-odd dollars over 10 per cent of the bank reserve, that is, 10 per cent of the outstanding contract balances; is that right?

The Witness: That is correct up to that point.

The Court: All right. Now, can you explain further now about this other matter that I speak of? Let me also ask you this: When you said that if there are any accounts in default, did I understand you to say when there are accounts in default the full amount of that particular account is [27] subtracted from that \$15,000?

The Witness: Correct.

The Court: And what else might ever be subtracted from the \$15,000 reserve?

The Witness: Any unpaid repossessions. Re-

(Testimony of Russell H. Simpson.)

possessions that the bank has returned to the dealer for payment which has not yet been received by the bank.

The Court: Who repossesses?

The Witness: The bank.

The Court: The bank repossesses?

The Witness: Yes.

The Court: Does the bank sell those cars, resell—

The Witness: No, we return them to the dealer under his recourse agreement with the bank.

The Court: That means you are going to—the bank will collect nothing more on the original contract with the purchaser?

The Witness: That's right.

The Court: And whatever you have advanced, you will expect to get back from the dealer; is that right?

The Witness: Correct.

The Court: And until that is paid to you by the dealer, do you subtract that from that credit balance, the dealer's credit balance of \$15,000?

The Witness: Right. [28]

The Court: Isn't that easier, an easier explanation than this matter of adding five thousand dollars over here, or is that something different again?

The Witness: No, sir, that is just an example.

The Court: And that is the same point you are trying to make, that I brought out?

The Witness: Yes, sir.

Q. (By Mr. Hankins): Well, then, assuming

(Testimony of Russell H. Simpson.)

that the outstanding balances at any one date was \$100,000 on these contracts assigned by the dealer to the bank, and that all of its 35-day accounts, overcharges for repossessions, and so forth, amounted to \$3,000 on that particular date, then you would take 10 per cent of this figure right here, or \$10,000 and you would add \$3,000 to that figure and come up with \$13,000 which you would compare then with the \$15,000 in the reserve, and if those were the conditions, then would the dealer be allowed to draw down the balance in excess of the \$13,000?

A. Yes, he would be allowed to draw down anything in excess of 10 per cent of his contingent liability.

Q. This is assuming that his outstanding contracts, contingent liability is \$100,000, this is 10 per cent you stated that you would add all accounts on which there was one payment past due?

A. We would deduct those accounts on which there was [29] more than one payment past due from his reserve.

Q. That is what I am doing over here——

A. And pay him the excess over 10 per cent on that figure.

Q. Then, this figure then is never subject to his immediate withdrawal?

The Court: What figure is that?

Mr. Hankins: The \$67.25 when it goes into his reserve account.

The Witness: No.

(Testimony of Russell H. Simpson.)

Q. (By Mr. Hankins): But the total of all figures that go into his reserve account, you make subsequent computations of, taking 10 per cent of outstanding balances, add to that all the contract accounts over 35 days past due, and if he has any excess, he has a right to receive that; is that correct?      A. Right.

The Court: Now, there is one point I would like cleared up on the record.

You say 10 per cent of the total of contract balances?

The Witness: Yes.

The Court: For example, in the example stipulation, it would be 10 per cent of line 9 in the example, namely, \$1416.05. [30]

Now, in the example that has been referred to by counsel of a million dollars outstanding of the contract balances, I understand you take 10 per cent of that, namely, \$100,000 and what would you call that figure, the \$100,000?

The Witness: A reserve account.

The Court: That is a reserve account that the bank sets up. Now, do you provide—do you proceed further in the computation and take 10 per cent of that?

The Witness: May I explain it this way: That portion, \$67.25 up in the dealer's reserve account gradually builds to a 10 per cent reserve, and that would be 10 per cent of the contingent liability sum total of all the contract balances of which have been assigned to us.

(Testimony of Russell H. Simpson.)

The Court: Off the record for just a moment.

(Discussion off the record.)

The Court: On the record.

Q. (By Mr. Hankins): At the time these contracts are assigned to you, do you pick up the total of the unpaid or the total of the contract balance on your books as accounts receivable at that time?

A. Yes, we do.

Q. Then, what is your offsetting interest to your contracts receivable, assuming that the contract was assigned to you and contained the identical figures which we have in [31] the stipulation?

A. On the debit side of the ledger contracts receivable would be a figure of \$1233 even. There would be a cashier's check for \$40 sent to the Department of Motor Vehicles.

Q. Cash, \$40,—

A. There would be credited to the unearned discount \$70.90—\$75.90, there would be a credit to the dealer's reserve account of \$67.25.

Now, we have an error in where it says "accounts receivable," that would be "cash to the dealer," \$1233.

The Court: That is debit on the books—

The Witness: Those amounts would make up the contract balance which would be—you would call it accounts receivable.

Q. (By Mr. Hankins): Then you would have accounts receivable—

A. \$1416.

The Court: \$1416.05.

Q. (By Mr. Hankins): Then, upon assignment



(Testimony of Russell H. Simpson.)

of this contract to the bank, you would pick up on the bank records contracts receivable of \$1416.05—15 cents, and your offsetting credits, you would pay the dealer \$1233 in cash and you pay the Department of Motor Vehicles \$40, and then, in your unearned discount [32] you would place \$75.90, and into the dealer's reserve account \$67.25?

A. That's correct.

The Court: When does the five dollars go into the earned——

The Witness: That is only when we buy the contract.

The Court: In other words, that figure \$75.90 represents both earned and unearned discount?

The Witness: Yes.

The Court: Very well.

Mr. White: May I interrupt? I don't believe the debits and credits are equal. I see, I am sorry.

Q. (By Mr. Hankins): Now, Mr. Simpson, when you make your computation at the bank to see whether the dealer is entitled to any money, do you look at the total of this contract balance which is represented by our typical example of \$1416.15 in order to arrive at a total amount on which you would compute your 10 per cent for determining how much might be available out of the dealer's finance reserve to the dealer? A. Yes; we do.

Q. Well, then, assuming that you added all of the contract balance which had been assigned to you by the Art Morgan Motor Company and those balances equaled one million [33] dollars and you

(Testimony of Russell H. Simpson.)

totaled up all of the accounts that were past for more than thirty-five days and the total of those such accounts totaled \$3,000 and the balance in the dealer's reserve account at that particular instance was \$15,764.32, would the dealer be entitled to receive any money from you?      A. No.

Q. Then, in the way you computed this, you would have taken your million dollars of contracts outstanding, and take 10 per cent of that which would be \$100,000 and compare that with the \$15,764.32, and the dealer's reserve, less than \$3,000 of over thirty-five-day accounts, leaving \$12,000 and since the \$12,000 is less than the hundred thousand, he is not entitled to any money?

A. That's correct.

Q. Now assuming that these contract balances that have been assigned to the dealer were to equal \$100,000, the dealer's finance reserve is still \$15,764.32, and the over thirty-five-day delinquent account is \$3,000, then would he be entitled to receive any money?

A. Entitled to receive \$2764.

Q. The way you compute that, then, is to take your \$100,000 of contract balances, take 10 per cent of that, \$10,000, and compare that with the \$15,000 less \$3,000 which leaves a balance of \$12,000, and since that \$2,764.32 is in excess of 10 per cent of the contract balance, he is entitled [34] to draw down the \$2,764.32?      A. That's right.

The Court: As I understand it, that is true at

(Testimony of Russell H. Simpson.)

any particular time that the dealer cares to pull it down?

The Witness: That's right.

The Court: If he does have a favorable balance?

The Witness: Right.

The Court: As a matter of fact, how do they do it? Every month?

The Witness: It varies with various companies, one large finance company every month, one large bank that I know of every month, and in our bank we do it on their request.

The Court: Yes.

Q. (By Mr. Hankins): Mr. Simpson, you mentioned in your testimony that there was no money represented by the credits to the dealer's finance reserve, for example — or \$67.25, that was only a bookkeeping entry on your books. What, if anything, must happen before the dealer would ever be entitled to receive any of this money in his dealer's finance reserve?

A. There would have to be some collected balances reduced, money received.

Q. In other words, the contract balance must be reduced? [35]

A. That's right.

Q. Before, under your contract with him the sum of these would never exceed the 10 per cent limitation which you have with the Art Morgan Motor Company?

A. That's right.

The Court: That is the sum of all the specific dealer's share items that are put in reserve account for the dealer on the individual account. That is the trouble, when you are looking at a blackboard,

(Testimony of Russell H. Simpson.)

you say "this," and it is hard to determine from the record what you mean.

Q. (By Mr. Hankins): In essence, then, Mr. Simpson, this is merely a first allocation of \$67.25, that is merely a bookkeeping record in the bank to determine what ultimately under your contract may be paid to the dealer; is that right?

A. That is correct.

Q. Mr. Simpson, assuming from our typical example that you have set forth in Paragraph 10 of the stipulation of fact that the blue book value of that car at the time it was assigned, the contract was assigned to you, was \$1,000, would you in that case give Mr. Morgan \$1233?

A. No, we would not.

Q. What would you do at that time with the contract?

A. We would probably put in a separate withhold account called "Art Morgan Motor Company Withhold Account," [36] the excess there of \$233 over the blue book value of a thousand.

The Court: Now, the purchaser would still be obligated to pay to the bank the \$1233, plus the other charges?

The Witness: That's right.

The Court: But since the car had a value of only a thousand, you would not pay to the dealer the full amount?

The Witness: That's right.

The Court: But only the amount that you figured the car was worth, but then I assume if it is paid out, you would pay that over; is that the idea?

(Testimony of Russell H. Simpson.)

The Witness: That is correct. As the account was paid down within the limit, we would refund some money out of the withhold account to the dealer.

Q. (By Mr. Hankins): Then, in essence, this is a security account for the bank on that account?

A. You could call it that, yes.

Q. And if these were the facts, the contract under unpaid cash balance of \$1233, the value of the car \$1,000, you wouldn't get around it another way by saying "we want all of this time price differential, plus some of the unpaid balance"; would you? [37]

Mr. White: Your Honor, I have been allowing considerable leading, but at this point counsel is putting words right into the mouth of the witness.

The Court: Mr. Hankins, would you rephrase your question?

Q. (By Mr. Hankins): Mr. Simpson, assume these are the facts, that the unpaid balance, unpaid cash balance of \$1233, the value is \$1,000. Is there any other way you would handle this contract besides taking the \$233 and putting it into the dealer's withhold account?

A. No, not unless we rejected the contract entirely.

Q. Mr. Simpson, do you know the purpose of the bank in setting up this dealer's finance reserve account credits which they have in the so-called dealer's reserve?

A. Yes, I know the reason.

Q. What is their purpose in doing that?



(Testimony of Russell H. Simpson.)

A. To further secure the bank against the dealer's guarantee to the contract, secure the dealer, the dealer guarantees a given account—say a million dollars in paper, in such case we want further reserve. The dealer is going to guarantee the contracts, he is going to charge a rate where he can get that contract, the bank sets a rate of 5 per cent for the dealer and the dealer may charge 8 per cent, the difference going into the reserve account and we keep [38] control of the reserve account.

Mr. White: Would the reporter read that back, please?

(Record read.)

Q. (By Mr. Hankins): Does the dealer guarantee all the paper assigned to you? A. Yes.

Q. Then, in part for that guarantee, then, of those accounts you make this type of arrangement with him where you will let him share in some of the dealer's finance reserve——

Mr. White: Your Honor, I object to the phrase "sharing in the dealer's finance reserve." I wish counsel would ask the witness a question and let him give a yes or no answer.

The Court: Mr. Hankins, I suppose that is probably a conclusion.

Q. (By Mr. Hankins): Mr. Simpson, do you know whether or not the purpose in setting up this dealer's reserve account for the dealer is for the purpose of getting the dealer to guarantee the paper to the bank? A. Yes, I know.

Q. Would you state whether it is or not for that [39] purpose, the purpose of securing the

(Testimony of Russell H. Simpson.)

guarantee by the bank of the paper which is assigned by the dealer to the bank?

A. I would say it is one of the reasons.

The Court: At the same time, the bank did have the security of the car itself, did it?

The Witness: That's right.

Q. (By Mr. Hankins): When these accounts were assigned by the dealer to you or to the bank, did the bank check the credit references of the purchaser? A. Yes.

Q. Did the bank ever reject any sales assignment of contracts to the bank?

A. Yes, we have.

Mr. Hankins: You may cross examine.

The Court: It might be well to take a short recess before cross examination.

We will recess for lunch for one hour.

(Thereupon a recess was taken at 12:30 p.m. to reconvene at 1:30 p.m. of the same day.)

After Recess, 1:30 p.m.

RUSSELL H. SIMPSON

resumed the stand, pursuant to recess, and testified further as follows:

Cross Examination

Q. (By Mr. White): Mr. Simpson, in your direct examination, you testified that the procedure used in the case of the Art Morgan Motor Company was the same as that used for all automobile dealers.

(Testimony of Russell H. Simpson.)

With that thought in mind, was the conditional sales contract the same form of contract?

A. Yes.

Q. And the contract which is in evidence as Exhibit 2-B, was that the same form of contract—I will show you Exhibit 2-B.

A. Standard form, standard dealer agreement that we use.

Q. In discounting conditional sales contracts or purchasing them from these other dealers, do you know if any time the sum which was credited to that dealer's reserve account was based on the unpaid balance shown on the sales contract, the conditional sales contract?

A. The best I can answer that is: We would figure the charge, the bank charge on the contract, on the contract [41] balance.

Q. By "the bank charge," you mean the discount?      A. That's right.

Q. Now referring to the credit which is a sum entered into the reserve account of the particular dealer, do you know if in the case of some dealers the bank would credit a sum which is based on the unpaid balance on the particular conditional sales contract being purchased from that dealer?

Item 7, if you care to look at it, is labeled "Unpaid Balance." It is Exhibit 1-A I am pointing to—I take that back, I should have said Item 6 is labeled "Unpaid Balance."

Now the question is: Do you know if in the case of other dealers the bank sometimes bases the

(Testimony of Russell H. Simpson.)

amount of credit to the reserve account upon the unpaid balance?

A. In our bank we do not figure on the unpaid balance. We figure on the contract balance.

Q. You figure what on the contract balance?

A. The bank discount.

Q. I am not referring to discount, I am referring to the sum which is credited to the reserve account.

The Court: To the dealer's——

Q. (By Mr. White): The dealer's reserve account? [42]

A. The unpaid balance wouldn't have any relation to the dealer's reserve.

Q. Can you state if you know at any time this bank, the Farmers & Merchants National Bank of Long Beach, based on that credit, that unpaid balance—the term, if I could rephrase it—used that unpaid balance to determine the amount which they would credit to the reserve account? A. No.

Q. Is that your answer that you do not know?

A. I would say we do not use the unpaid balance to determine the amount of reserve to go into the dealer's reserve account.

Q. Can you state to your knowledge that that has never been done in the Farmers & Merchants Bank?

A. To my knowledge, it has not been done.

Q. But you cannot state it has not been done?

A. I can state it would not be done as a matter of policy to the bank.

(Testimony of Russell H. Simpson.)

Q. The next question is: What would be the method of determining the amount to be credited to the dealer's reserve account?

A. We compute the bank discount—we subtract that from the time price differential, as referred to in Exhibit A, and the balance that is left would be credited to the dealer's reserve account. [43]

Q. Are there any other methods of determining the amount to be credited to the reserve account?

A. Not in our bank.

Q. In the instant case, in the example we have used on the blackboard, you see a sum of \$1,233 which was the sum paid by the bank to the dealer.

What if the bank decided that it considered that too much to be paid to the bank, even after its normal discount and wished to put a larger sum in the reserve?

A. If there were too much money to be paid to the dealer from the contract, it would not be put in the dealer's reserve, it would be put into the dealer's withhold account.

Q. What if there is no time price differential, Mr. Simpson, then what do you credit to the dealer's reserve?

A. We wouldn't have any credit to the dealer's——

Q. How is that?

A. We wouldn't have any credit to the dealer's reserve if there were no time price differential.

Q. What would you use as your security on that contract?



(Testimony of Russell H. Simpson.)

A. We probably wouldn't buy the contract.

Q. Supposing you did buy it, there is nothing holding you from buying it if it looks like a good contract at a fair price and you wish to purchase that contract, then what would you credit the dealer's reserve? [44]

A. If there is no time price differential, there is no discount, we wouldn't buy the contract.

Q. Why wouldn't you?

A. At a discount?

Q. Yes.           A. Simply isn't done.

Q. You may not do that as a matter of course, Mr. Simpson, but in your knowledge of banking, why is it impossible to buy a note or a conditional sales contract which doesn't have the finance charge on it?

A. I don't know of any instance where that has been done.

Q. Can you think of any reason, any principle of banking, which would make that impossible?

Mr. Hankins: I object to that, your Honor. These facts he is trying to bring out are not in evidence, in the first place, and we have an example here in evidence that we have been using for a typical example, and the man has stated that they don't do it there, and he is only asking for his opinion or what may happen in other banking circles, and I don't think it is properly put, it is not a proper question.

Mr. White: I think in a few moments we will

(Testimony of Russell H. Simpson.)

get to the propriety of the question. If you wish, I will make my point immediately.

The Court: If you think it is material and can link [45] it up, go ahead. It does seem hypothetical and beyond the practice here, but go ahead.

Q. (By Mr. White): Is there any principle of banking which makes it impossible to purchase a conditional sales contract without a price differential?

A. I don't know of any exception to our present procedure.

Q. If the bank purchases a conditional sales contract without a time price differential at its usual discount rate, why wouldn't it earn its usual interest or usual type of income?

A. I'm awfully sorry, but would you give me that again?

Q. If a bank were to purchase a conditional sales contract that does not have a time price differential, purchase the contract at its usual discount rate, four and a half per cent a hundred of the contract balance, assuming the contract is paid in full in the normal course, won't the bank then earn its discount or interest just as if there had been a time price differential?

A. I can only say the bank would never purchase a conditional sales contract on that basis.

Q. I will ask you another question. The sum of \$67.25 was credited to the dealer's reserve. Now, I have allowed Mr. Hankins, counsel for the Petitioner, to [46] say that this is a part of the time

(Testimony of Russell H. Simpson.)

price differential, and you say it is part of the time price differential. Now, we have in this case a contract balance which is more than \$67.25, it is \$1,416.15. Now, I want you to tell the Court by what earmark on this sum you can say, unqualifiedly, that it comes from the time price differential and not from the contract balance. What is the earmark? What is the identification of that sum which assures you it came from the time price differential and not from the contract balance?

A. We would figure the bank charges and from the contract balance, after we arrive at that balance, we would take the \$143.15, which is the time price differential, and that identifies it, earmarks it.

Q. The bank discount in that case was \$75.90?

A. Correct.

Q. Assuming the time price differential was \$75.90, then what would you credit to the dealer's reserve account?

A. There would be no credit.

Q. Would you then pass up the contract? Would you necessarily pass up that contract?

A. We may, yes.

Q. If you do not, what would you credit to the dealer's reserve?

A. If we passed the contract up, there would be no [47] purchase, there would be no interest.

Q. What?

A. We probably wouldn't buy the contract.

Q. That is a probability. Another probability is that you would buy it. Assuming you bought this

(Testimony of Russell H. Simpson.)

contract, your discount is \$75.90, what would you credit to the dealer's reserve?

Mr. Hankins: I still object to that, your Honor. He is assuming facts not in evidence here, that they did buy a contract of \$75.90 and for the dealer's finance reserve the time price differential was shown on there. We have no facts in evidence that there was a contract of that nature.

Mr. White: Your Honor, if the only issue is this one contract the petitioner would have a point, but we are dealing with an example. If the petitioner can use it as an example, how can this witness unqualifiedly tell the Court that that sum of \$67.25 comes from the time price differential and could not possibly come from the contract balance?

The Court: I think it is proper to test this out and with the understanding, of course, this witness has said they do not buy contracts under those circumstances.

Q. (By Mr. White): Now, assuming you did buy a contract which had a time price differential and you took your normal discount which might be a dollar less but approximately \$75.90, in [48] that case what would you credit to the dealer's reserve?

A. Well, first of all, if we bought a contract under such conditions, we would charge an additional rate for the contract.

Q. You mean an additional discount?

A. That's right.

Q. You——

A. We would not be able to ask the dealer to

(Testimony of Russell H. Simpson.)

sign the contract "with recourse," therefore, it would become a direct bank deal, there would be no liability on the part of the dealer in the occasion of repossession or default.

Q. You could still buy this contract with recourse on the part of the dealer, the dealer is fully liable under guarantee as under any—now, we are postulating a case where the bank purchasing this contract in the usual way with recourse charges, its usual discount of approximately \$75.90, I ask you, under those circumstances what would be credited to the dealer's reserve?

A. We wouldn't buy a contract on that basis.

Q. I think you see the point of my question, Mr. Simpson. I am trying to illustrate the Government's position that you can't point to \$67.25 and say "it has this particular earmark, it is this color or this shape, therefore, it came from the time price differential." The Government says "How do you know it didn't come from the contract balance which is [49] certainly large enough to include it?"

Mr. Hankins: I object to that as arguing with the witness, your Honor. If counsel wants to testify——

Mr. White: I will ask that my tone of voice be excused, but I think the witness is avoiding my question and that is the reason I am a little bit anxious to explain the purpose of this. We can forever postulate the example and he can forever say they wouldn't buy it, but we are assuming they do buy it. It doesn't strain the imagination at all. I asked "If



(Testimony of Russell H. Simpson.)

that is what happened, what would you credit to the dealer's reserve?"

The Court: The witness is in a difficult position there to state what would be done if it has never been done. I don't know that he makes up policies of the bank, but I see the point you are driving at and I would like for the witness to say under the theory, as he understands the bank's approach on this, would you under those circumstances put anything in the dealer's share; if such a thing were done, would you with your knowledge of the system which you employ?

The Witness: Your Honor, I just have never heard of a case of that kind, and I would have to pass. I wouldn't know of a way that it could be done, unless the loan was submitted to us in a different form on a—say, a general pledge, or something of that kind whereby a number of contracts at the rate, but not on an individual sales contract for [50] an individual dealer.

Q. (By Mr. White): Let me ask you this question, Mr. Simpson: How do you determine the adequacy of the sum that you are crediting to the dealer's reserve?

A. Our experience with dealer paper, as a whole, is with the dealer himself.

Q. So it could be a case identical with this one where you would credit more to the dealer's reserve?

A. No, we can't credit more to the dealer's reserve unless he gets additional charges.

(Testimony of Russell H. Simpson.)

Q. You said that on direct examination. I didn't understand that and perhaps the Court didn't. Why couldn't you credit more to the dealer's reserve?

A. We could if the dealer charged more or charged a bigger rate when he sold the automobile.

Q. When you say "charged rate," you mean took a high discount? A. Yes.

Q. Assuming you didn't, is there any reason you couldn't charge more credit to the reserve than \$67.25?

A. In this particular case, we couldn't.

Q. Why not?

A. Because the dealer's rate is set for all contracts.

Q. Set by whom? [51]

A. Farmers & Merchants Bank.

Q. The Farmers & Merchants can alter it, then?

A. Well, dealer rates are set because of competitive reasons within the trade.

Q. If in the opinion of the Farmers & Merchants National Bank, the condition permits to credit larger sums to the dealer's reserve, what is to keep it from doing so, Mr. Simpson?

A. We would have to give our dealers a notice of 15 or 30 days that we were going to raise our rates to them.

Q. If Mr. Morgan came to you today and said, "Would you purchase this conditional sales contract?", couldn't you tell him then and there, "first of all, Mr. Morgan, we want four and a half per

(Testimony of Russell H. Simpson.)

cent as a discount, and in addition \$70 credited to the reserve account?

A. I suppose it would be possible to say that to Mr. Morgan. I don't believe we ever have, but we might take a withhold and put it in his withhold account.

Q. Assuming the dealer's reserve balance, the credit balance, is in the deplorable condition of very low, and he comes to you with a contract for an automobile and maybe the unpaid balance is approximately \$10,000, must you at this point again restrict yourself to the time price differential or could you tell him, "This is an extra-risky contract and we want more put in the reserve"? [52]

A. No.

Q. Why not?

A. Either take a withhold on the account, or we would reject the contract.

Q. Now, this withhold account, is that a credit?

A. That is a credit.

Q. You credit that account. Is it shown as a liability?

A. On Mr. Morgan's books it would be an asset, to the bank it would be a liability.

Q. It is shown as a liability?

A. In the bank.

Q. What is the purpose of that account?

A. That is just for the security as far as the bank is concerned. In other words, we are going to advance the market price of an automobile or a contract calls for a balance in excess of the market

(Testimony of Russell H. Simpson.)

price and we take the difference and put it into the withhold account.

Q. That account is for security purposes?

A. That account is to secure that particular contract.

Q. The reserve account, what is the purpose of that account?

A. To induce the dealer to discount contracts with us, sir.

Q. Is it a security account? [53]

A. A security as far as the dealer is concerned.

Q. And it is to secure the bank?

A. So far as the bank is concerned, it is a method of getting business.

Q. Isn't it to secure the bank, to assure the bank that the dealer will meet all liabilities to the bank?

A. It also acts in that capacity.

Q. How is that?

A. It also acts in that capacity.

Q. Is that a credit account—is that a credit, Mr. Simpson?      A. Credit.

Q. Is that shown as a liability?      A. Yes.

Q. Now, you tell the Court, how does that account differ from the so-called withhold account?

A. Very simple. On the withholding account, each individual account is refundable at the time it is paid down to a balance that is within the bank requirements.

On the reserve account, the reserve account as related to the contingent liability of all contracts put together——

(Testimony of Russell H. Simpson.)

Q. So, as I understand your testimony, the only difference between the two accounts is that one can be tied in at any particular moment to a contract that would be your [54] withholding account, and your reserve account cannot be tied in with any particular contract, depends on the total unpaid balance? A. Correct.

The Court: On the withholding account, in the example where a car was taken in at a value of \$1,000 and the selling price was \$1233, and there was a withholding account of \$233, you would pay that individual amount to the dealer whenever conditions warranted it in the bank's estimate, is that right? And that would not have any effect on your calculations of how much at any given time the dealer could claim from the dealer's reserve account, is that correct?

The Witness: That is correct, sir.

Q. (By Mr. White): Would you refer to Paragraph 10, Mr. Simpson, of the stipulation. Paragraph 10, I'll run down this particular contract to make sure we all understand what occurs.

The contract balance, which is Item 9, is approximately \$1400?

A. The dealer comes to the bank and says, "Will you purchase this?"

The bank says, "Yes" or assignment is made, the bank purchases that contract for \$14,000, less its discount.

The Court: \$1400. [55]

Q. (By Mr. White): The contract balance is



(Testimony of Russell H. Simpson.)

\$1400, approximately \$1400, to be exact, \$1,416.15.

Now, when the dealer comes in and asks if you will handle this contract, Mr. Simpson, you would purchase it for that sum, less the bank's normal discount?       A. No.

Q. What sum would you purchase it for?

A. We purchased for Item 7, the unpaid balance.

Q. Let's run through on that. You would pay \$1,273 in cash to the dealer?

A. Yes. I must qualify that one item, \$40 item. If we cleared the title, we had to send that \$40 to the Department of Motor Vehicles, then we would pay \$100—\$1233 to the dealer and send \$40 to the Department of Motor Vehicles, and we would have an unpaid balance of \$1273.

Q. Assume the dealer cleared the title and paid the \$40 to the Motor Vehicle Department, you would pay the dealer \$1,273?       A. Right.

Q. All right. That would go to him in cash, and then you would withhold this dealer's reserve of \$67.25. I am going to make some mathematical computations.

The contract balance is \$1416.15. If we subtract from that \$75.90, which is the bank discount, using the [56] example you gave on direct examination, that would leave a balance of \$1,340.25. Then if we subtract from that \$1,340.25 the amount which you credited to the dealer's reserve, the difference would be \$1,273.

Now, how can you tell the Court that the only

(Testimony of Russell H. Simpson.)

way to compute this is by going to the unpaid balance and say "We paid him that sum"? What is the gross error by the respondent's theory to say that which you paid him is a contract balance, less your discount and less sum credited to the dealer's reserve? I'll go through it again——

The Court: Just a moment. The witness said he didn't see there was any gross error there, is that right?

The Witness: I don't—I may have missed a point there. I see no gross error of any kind.

Q. (By Mr. White): I will take a moment to explain again. I don't want to argue with you. The Government contends that the bank doesn't buy unpaid balance shown by time price differential, the bank buys a contract balance——

Mr. Hankins: I object to this——

The Court: He is explaining. I think he is telling the witness what the contention is for the purpose of clarification only.

Mr. White: I am giving the Government's position, and he can show the Court where the Government is wrong. [57]

The Court: I take it there is no argument with the witness at all, you are doing this for the purpose of explaining?

Mr. White: That is absolutely correct.

The Court: Now, what is your question again?

Mr. White: The question is: How can this witness assure the Court that the sum which is paid to

(Testimony of Russell H. Simpson.)

the dealer in cash is not the contract balance less the discount and less the credit to the reserve?

The Witness: Now, the last part of that again, please?

Q. (By Mr. White): I say, how can you assure this Court that the sum paid to the dealer in cash is not the contract balance after you have subtracted from your discount and your credit to the reserve account?

A. Well, the two are the same, the way you figure it out, but actually in practice they are not, because one cash is paid out—I mean the cashier's check is a bookkeeping entry, there is no money—no money has been received yet on this contract, it can't be anything else but a book entry. It is merely a distribution of anticipated receipts which is part of this contract.

Q. Isn't it correct, Mr. Simpson, that the sum you are distributing is the sum in No. 9, the contract balance? [58] You take that sum and say "We will distribute it in this manner, part will go in cash to the dealer and part will be retained by us as our own organization discount, and part will be placed in the dealer's reserve account"?

A. That's right, no argument about that.

Q. So, I ask—my question, again, is about the sum which is credited to the dealer's reserve account. By what test, by what determination can we say that the \$67.25 necessarily came from the time price differential and did not come from the contract balance?

(Testimony of Russell H. Simpson.)

A. One is cash and the other is a book entry. One entry is cash balance and the—how much cash is being expended, and Item 8 is a book entry, because no cash has been received and Item 9 is a total of the two.

The Court: May I ask at this point, to clarify my own thinking, isn't it true that at this particular time, when you take the contract, not only has the purchaser not paid any of the time price differential, but he hasn't paid any of the principal amount of the purchase price of the car?

The Witness: That's right.

The Court: So to that extent they are similar, namely, the bank hasn't yet gotten any money from the purchaser, but it does disburse to the dealer a certain amount of cash, namely,—How much here in this case?

The Witness: Well, your Honor, down to line 7 [59] cash has been disbursed by the bank.

The Court: I see, the twelve hundred and seventy-three?

The Witness: That is correct.

The Court: Yes. You have disbursed that to the dealer?

The Witness: To the dealer or to the Department of Motor Vehicles.

The Court: Or in some cases for the Motor Vehicle tax, the \$40 in some cases?

The Witness: That is correct.

The Court: Whereas, on the time price differential, which is something that the purchaser of the

(Testimony of Russell H. Simpson.)

car is also liable to pay, that is not disbursed immediately to the dealer, but a portion is set up, some portion is set up in a reserve for the dealer, as you described in your direct testimony, and part of it is set up on your own books as what you—what did you call that?

The Witness: Unearned discount.

The Court: Is that called an unearned discount also? There is additional discount, is there not, that you——

The Witness: There is. In other words, the rate plus five dollars. The five dollars is earned and that goes into earned discount, but the balance goes into unearned discount and that is never taken out until the entire contract [60] has been made, and is transferred from unearned to earned discount, and the bank has earned it.

The Court: I am a little confused again. Perhaps the record shows the correct picture, but how about the \$75—I see, that is divided, that figure of \$143.15 you say is divided into \$75.90 which includes both earned and unearned discount for the bank and \$67.25 which is the dealer's share put into the dealer's reserve to be paid under circumstances you have described before.

The Witness: Right.

The Court: Now I have this question: How do you arrive at the \$75.90 again as being the bank's share of that?

The Witness: By the rate we charge the dealer.

The Court: Is that a specific rate?



(Testimony of Russell H. Simpson.)

The Witness: I believe at this time, and I am going to have to ask Mr. Morgan to develop that, I believe at that particular time our rate to Art Morgan Motor Company was 4 per cent on the gross balance of the contract.

The Court: On gross balance of contract, which would be what figure here?

The Witness: Line 9.

The Court: Line 9——

The Witness: 4 per cent, plus \$5 would equal \$75.90. [61]

The Court: I see. You would figure 4 per cent of \$1416.15?

The Witness: May I add this, your Honor, it would be 4 per cent per annum, this contract, I believe, is a fifteen-month contract.

The Court: I understand that. So it would be at the rate, though——

The Witness: 4 per cent.

The Court: \$1416.15, and then to that you add \$5?

The Witness: That's right.

The Court: The other question I had was this: Is that rate set forth in any contract with this partnership?

The Witness: Subject to change, your Honor; it may be set forth in a contract and it may be changed later.

The Court: I see. Off the record for a moment.

(Discussion off the record.)

The Court: On the record.

(Testimony of Russell H. Simpson.)

Then, as I understand it, the rate of discount which the parties may have agreed upon is applied to Item 9, namely, "Contract balance," which determines the amount of discount which the bank is to have, and then that figure is subtracted from the figure which has been designated here as time price differential, \$143.15, in order to determine how much goes into the dealer's share reserve? [62]

The Witness: Correct.

The Court: And if the dealer should choose to charge a greater rate to the purchaser of the automobile, greater than the \$143.15, as set forth here in this example, then any excess he charged would then go into the bank's records as a credit to the reserve for the dealer's share?

The Witness: That's right.

Q. (By Mr. White): Continuing on that line, Mr. Simpson, what is troubling me, I mention this again by way of explanation so you understand my question: Is it that the bank wants this credit for security purposes, it wants to be assured [63] in some way that the dealer will meet his obligation?

Yet, the second point we seem to make that the amount be credited is just left to the dealer, depending on what he decided to charge as a time price differential because it's always going to be the leftover after you reduce that sum by the bank's discount, which in this case is \$75.90. If you felt as though—it seems to me that in that case you might have only a few dollars left over to go into this reserve and the bank would not be fulfilling its

(Testimony of Russell H. Simpson.)

obligation—objective of seeing that each contract bears—has some reserve to assure its dealer's liability.

So, with that thought in mind, I ask you this question: Assuming the dealer for some reason did not charge [63] \$143.15 as time price differential, but charged a lesser sum; in that circumstance—correct me if I am wrong—the bank will still take the usual discount rate of approximately \$75.90; is that correct?

A. Go ahead with the rest of it.

Q. All right. Is the bank then with hands tied, is that it? It cannot insist on \$67.25 going into the reserve account?

A. Is the bank's hands tied in insisting they cannot go into the \$67.25 credited to the reserve account? Your question is a hard one to answer, because I have never known a dealer to guarantee a contract unless he got paid something in his dealer reserve account and, as I think I mentioned before, if we bought such a contract it would have to be on a direct bank deal, it couldn't be guaranteed by the dealer, it would be the bank's deal with the purchaser and then we would consider a direct bank loan and we would not charge four and a half per cent, we would charge six per cent.

Q. This time price differential, Mr. Simpson, and this credit to the reserve has been referred to as sharing in the time price differential and at other times the credit has been referred to as a security. What if at the time this contract was as-

(Testimony of Russell H. Simpson.)

signed you had a large credit balance, far in excess of 10 per cent of the unpaid contract balance, would you insist on a credit of \$67.25 to the reserve? [64]      A. Yes.

Q. Why would you do that?

A. So the dealer continues to build up and continues an equity in his reserve.

Q. We are assuming a reserve which at that time was in excess of fifteen months, you would then pay a credit of \$67.25 and if at that moment the dealer insisted on you paying him \$67.25, you would be obligated to pay him that cash, \$67.25, am I not correct?

A. I couldn't visualize such a situation, it isn't the usual thing. I have never heard of him wanting a particular reserve in that exact amount.

Q. Assuming he asks for \$100?

A. Somebody asked for two thousand or twenty-five hundred, fine; but we wouldn't want the dealer continuing to put money in his reserve.

Q. In effect, it—isn't this situation I have just outlined one in which there is no credit to the dealer's reserve——

A. You see, it wouldn't be that \$67.25 he would be getting, it would be the \$67.25, that equity built up by contracts that had earned the charges paid off, and so forth.

Q. Now that gets us back again to how do you identify the \$67.25 and say that it's this one and not that one?

A. You don't identify any particular one and

(Testimony of Russell H. Simpson.)

you [65] don't pay any particular one, you pay it on equities in the reserve.

Q. Would the bank insist on this credit in the reserve, Mr. Simpson, if the partnership deposited with the bank collateral or cash which is always 10 per cent in excess of unpaid balance?

A. There would have to be some reserve for this reason: that on thirty-month contracts and with a \$450 discount and, say, \$150 is going to the dealer's reserve and \$300 going to the bank, and in one month if that customer came in to pay that account off, we would have to have a reserve to charge the refund on our charges.

Q. Would it be possible to charge to this deposit of cash which he left with you?      A. No.

Q. Why not?

A. There would be no accounting for it.

Q. Why couldn't you make a debit to that accounts payable instead of a debit to the reserve account?

A. He made a cash deposit to a specific reserve.

Q. He deposited with you a sum far in excess of the 10 per cent of the unpaid balance at this particular time, and far in excess of what it has ever been in the last five years, and he gave it to the bank and says, "This is security for my obligation, my obligation as guarantor of conditional [66] sales contracts, under those circumstances would it be necessary to credit a reserve when a contract is assigned to you?

Mr. Hankins: Your Honor, he is bringing in a



(Testimony of Russell H. Simpson.)

lot of conjectures in this thing. Each case depends on its own facts. In that particular case, we are surmising what would happen in any unusual situation and those unusual situations didn't happen here, he never showed that any happened here, and I object to this type of cross examination of the witness. If he sticks to the facts in this particular case, fine, but we can surmise almost any kind of possible situation.

Mr. White: Your Honor, there is a purpose to this. The witness has used such terminology as this credit being a sharing in the time price differential.

The Government's position is that is merely a security, a credit made for security purposes. There are no shares.

Now, I am bringing this up to illustrate that by showing if the bank is adequately secured by a deposit of cash made by the partnership which is far in excess of the 10 per cent of the unpaid balance, in that circumstance the bank would not credit a dealer's reserve.

Now, I am asking Mr. Simpson if that is true.

The Court: Well, it does seem we are getting pretty [67] far beyond the actual facts of the case. As I understand it, the dealer does guarantee the bank on these contracts.

The Witness: That is correct.

Q. (By Mr. White): Does the dealer ever put up any money as security for its obligation to the bank?

(Testimony of Russell H. Simpson.)

A. Only one instance that I know of in the twelve years that I have been with this particular bank has any dealer put in as much as \$1,000 in his reserve account, and that was to start him off in a new venture, and that was a voluntary action on his part to induce the bank to take his contracts.

I have never heard of some of these other situations, people do not—dealers do not put cash in reserve accounts.

The Court: What is your question again?

Q. (By Mr. White): The question is perhaps misunderstood. I didn't say, Mr. Simpson and your Honor, the dealer comes in with cash or, let's say, some highly secure collateral, bonds of the United States Government, and puts them on deposit with the bank and says "Here you put this in your bank as security for my obligations either on loans I make or on conditional sales contracts which I sell to you. I authorize you to deduct from that cash or from those bonds any default, any payment—where one of these refunds with time price [68] differential, if there is any, repossession, anything of that sort which I am liable or obligated to you for, withdraw from that cash or debit this account."

That is what we are assuming, a physical deposit of either cash or high-grade security.

The Court: And then your question is, if that were done, would the bank insist on withholding this \$67.25 in a reserve, or would it pay that amount out at the same time that it paid the great bulk of the contract at the beginning?

(Testimony of Russell H. Simpson.)

Mr. White: Exactly. That is my question, your Honor.

The Court: Well, again the witness is in a difficult position, because he says that it is never done.

Q. (By Mr. White): I will ask you: Would there be any purpose in crediting a reserve under those circumstances?

A. Well,—

Mr. Hankins: I still object to that type of questioning. The witness has stated time and time again that they don't do that, and how can he conjecture and say what they would do if they have never done it before?

Mr. White: We are testing the theory of this, and if he knows the theory and reasons for it, he could then tell us if there is any reason for crediting under those [69] circumstances.

Mr. Hankins: I think we are actually talking about what they actually do in this particular controversy, the petitioner, what he did in this situation and what the bank does generally, and I think that controls our issue in this case, what were the actual facts here, not what could have happened or if something else had been in issue, or some other factual situation had been presented, but I can't see that that has any bearing or relevancy on the issues in the case at hand. I think only the facts in this particular case are in issue, without any conjecture. That is too far-reaching.

Mr. White: I might add this witness is classifying, he is concluding. He says "this is a sharing in

(Testimony of Russell H. Simpson.)

the time price differential." He says "this comes from time price differential, and it couldn't ever—doesn't come from the contract balance."

The Court: That is the reason, of course, I have been allowing the examination thus far. I will permit the witness to answer; if he doesn't know the answer, he can say so, or if he wishes to say what would be his view of what would happen, as an expert on these matters, he may answer that, understanding all the while that those are not the facts in this case.

Can you answer that, Mr. Simpson?

Mr. White: Perhaps I could restate the question. [70]

Q. (By Mr. White): My question was: In these circumstances, would the bank have any reason or purpose in crediting a dealer's reserve account?

A. Let me try to explain it this way: My business is a business of decimal points and documents and balances. For every debit there must be a credit, and so forth, so all I can go on is how I know use and custom to be within this particular type of business I am in. If we were going to take a guarantee that was substantial, a dealer who had a net worth way up in six figures and he had stock or bonds, or something like that, we would probably continue a guarantee and put it in the file.

Now, this is actual practice, knowing him to be honest and reliable and a man of some background within our own community, we would then take his



(Testimony of Russell H. Simpson.)

continuing guarantee and let him keep the stocks and bonds and we still insist he set up the reserve from the contract and any losses that would go on above his credit to the reserve account, we would call on him to pay off on those losses from his personal resources or from his company or corporation.

Now, that is actual practice.

Q. You say you would do that, even though he did deposit with you a sum of cash which is more than enough to take care——

A. Well, as I said—— [71]

Mr. Hankins: I don't think he said that.

A. (Continuing) ——we would ask the man to keep his reserve account with us intact and the balance entered at all times so, No. 1, we could charge refund on prepayment and would have to have some place to charge them, you see, and, No. 2, if he were not available or in case of demise or sickness or he had a judgment against him, an attachment, or we could go on for a number of reasons, we would still want something under our control so that we could say “these are the inducements that caused you to come in our bank and discount contracts with us.

“And should we suffer a loss, then we have an account to charge those losses to until such time as we can recover from you.”

Q. Can you charge to losses to an account which is—which represents a sum of cash, if he deposits cash with you?



(Testimony of Russell H. Simpson.)

I suggest he deposit a million dollars in cash. Using that sum, wouldn't the bank make this entry, debit cash, one million dollars, credit accounts payable one million dollars?

When there is a default, whether it is this man's obligation——

A. In actual practice, we would have to have some guarantee in writing, such as a form of continuing guarantee, or some other agreement, perhaps like this, whereby we could [72] recover under the bank right of offset and we would insist on that dealer having a reserve under our control.

Q. Why wouldn't the cash on deposit be in your control?

A. It could be within the limits of any agreement, such as we have here, or that continuing guarantee, but we would still be subject to judgment, suits, and so forth.

The Court: I think maybe we have pursued this far enough. I take it, Mr. Simpson, you are saying you could have most any kind of an agreement that you wanted to with a dealer, if he wanted to put up a large cash deposit and agreed, you could charge losses against that, it could be done theoretically?

The Witness: Theoretically only.

The Court: I understand that, but I take it that is what he is asking you, it would be possible to do it if the parties agree to it?

Q. (By Mr. White): And my next question, Mr. Simpson: If that were the case, would there be

(Testimony of Russell H. Simpson.)

any purpose in the bank insisting on dealer's reserve of credit every time they purchased a contract from him?

A. It's my personal opinion, as I said here, as an employee of the bank, we would insist on a reserve to the extent of override on the charges. [73]

Q. What would be the purpose of that?

A. I just mentioned those reasons.

Q. I didn't get your reason. I will ask the reporter to——

A. We didn't strictly under our control without having to contact anyone to see whether or not they would agree that we would charge this reserve account.

Q. That is where you vary the facts.

We assume a case, say he gets a blanket right to debit that account at any time——

The Court: We don't want to argue, of course.

The Witness: We would, I assure, insist on reserve. We have no exceptions on that in our bank, at least, and that is all I can talk about, what we have in our bank. There is no exception to that rule in our bank.

Q. (By Mr. White): Referring again to this matter of sharing the time price differential, is the bank sharing in the time price differential or is the bank merely earning its discount rate—I will put the question again. I will give a preface. This is a bit complicated and I feel as though these prefaces are necessary.

The Government's contention is the bank earns

(Testimony of Russell H. Simpson.)

the discount which is, in this case, approximately four and a half per cent, not the time price differential, so my question to [74] you is this: Is there a sharing between the bank and the dealer in this sum of interest known as time price differential or does in fact the bank merely earn its discount, namely, four and a half per cent, and does not share in the time price differential?

A. The answer to that would probably have to come in two parts, conceivably as written on the blackboard——

The Court: Of course, you are asking this witness for a conclusion on the question involved in a case, are you not?

Mr. White: I suppose I am, your Honor, yes.

The Court: I think we are concerned with the basic facts, and I think some of my questioning brought out some of the basic facts of what the bank charges and what the bank is entitled to.

Would you care to withdraw that question?

Mr. White: I think I will withdraw the question.

Q. (By Mr. White): Referring now, Mr. Simpson, to the payments, the time price differential which is no longer due when the purchaser pays off the contract prior to maturity, will you first state to the Court: is there a cash sum which is refunded to the purchaser under those circumstances?

A. If he pays it out before its maturity, well, it wouldn't be a cash sum, the refund would be deducted from the— [75] from his unpaid balance.

Q. Am I correct, you would merely reduce the

(Testimony of Russell H. Simpson.)

sum still unpaid?      A. That's right.

Q. The bank in that circumstance, as I understand your testimony, would debit the dealer's reserve account for a portion of that sum which is no longer collectible from the purchaser.

How does the bank determine what portion to debit, how much to debit?

A. We do it on the percentage basis for the time that the money has been outstanding, the term of the loan based on what the bank earnings are.

Q. By "earnings," whose earnings?

A. The bank's earnings.

Q. Is there a formula known in advance which is used for that determination?      A. Yes.

Q. If it is not complex, would you explain it to us, Mr. Simpson?

A. Rebate schedule for installment loan charges. In this particular case, I think this contract we are talking about, we refunded based on a prepayment of six months on a ten months—fifteen months contract. A fifteen months contract is paid before the sixth installment is due, we would [76] refund 37½ per cent of the time sales markup.

Q. How is the 37½ determined, why that percentage?

A. That percentage is determined by those analysts who figure earnings on a consumer loan or installment loan, installment loan charges as prepared by the consumer credit department of the American Bankers Association.

Q. It is not, then, based on the percentage of the

(Testimony of Russell H. Simpson.)

time price differential that originally was credited to the reserve account?      A. No.

The Court: I am not sure that I have that entirely straight. We know that the bank has a certain percentage charge based upon this figure in the example of \$1416.15.

Now, if the time comes that the purchaser of the car pays up in advance, the bank is certainly going to relinquish some portion of the time price differential that it is entitled or would be entitled to receive if it went to maturity?

The Witness: That's right.

The Court: Now, in a situation—that figure of \$143.15 could be a very variable figure, depending on what the dealer wants to charge, as I understand?

The Witness: That's correct.

The Court: Do you at the time of prepayment of one of these accounts by a purchaser of a car figure the [77] amount of the dealer's share of the reserve which is to be refunded, which was originally credited to the dealer's reserve? You figure that at the same time, also?

The Witness: Yes.

The Court: And at the same rate and by the same table?

The Witness: By the same table we would rebate to the customer on the \$143.15, that would be what our rebate would be figured on and whatever that happened to be in this particular case—I don't see the figures on the board, \$44.20. The \$44.20 in this



(Testimony of Russell H. Simpson.)

case would be the refund to the purchaser. Now, then that \$44.20 refund must be shared by the bank and by the dealer, so there would be, then, \$22.83 charged to the bank's unearned discount account and it would have \$21.37 charged to the dealer's reserve account, meaning then those figures below indicate it would have \$40 earned—\$48 earned by the bank and \$45 earned in the dealer's reserve.

The Court: To make it somewhat simpler, taking the actual figure there of \$143.15, which was—which is denominated time price differential, you had previously set up \$75.90 as the bank's charge based on the percentage of the figure, contract balance, \$1416.15, then when the contract is paid up in advance of maturity, you apply your rate to your share, the \$75.90, and figure how much you will have to refund to the customer, which will of course leave you a [78] lesser earning, lesser amount earned, than you might have expected had it gone to maturity and the other figure, \$67.25 which has been previously put into the dealer's reserve, and that could have been a variable figure depending upon the rate charged by the dealer, you would apply your same table to that and forego the collection of any more. There is no refund involved, is there? You haven't collected this full amount of \$143.15, isn't that true, you haven't collected it at this point?

The Witness: We have collected a portion of it.

The Court: You have collected a portion of it, all right. Would there still be some refund or would

(Testimony of Russell H. Simpson.)

it be a matter of simply foregoing collecting of any further amount?

The Witness: No refund, credited to the unpaid balance of the contract, \$44.20, as you will notice on the blackboard, where it says "Unearned discount."

The Court: That is right.

The Witness: Now, over on the dealer's share, that \$67.25, when the \$44.20 is broken down in to the bank's share of the refund and the dealer's share of the refund, there still is a difference of only a couple of dollars between the two, so the remaining equity—it remains equitable all the way through.

The Court: I don't understand where we get the matter of refund when the customer hasn't paid the \$143.15. [79]

The Witness: Because it was added in his contract for the full term of the loan, that was the charge for the full term of the loan. If the loan doesn't run the full term or, in this case, runs less than half of the loan full term, he is entitled to a part of those charges. If he pays in six months, he should get approximately nine months refund on charges. If we couldn't collect the same amount of discount, we would charge for fifteen months.

Q. (By Mr. White): Upon the payment prior to maturity by one of the purchasers, the dealer's reserve account is not necessarily *debted*, the dealer may come and pay a sum in cash directly to the bank equal to his share. What I was trying to de-

(Testimony of Russell H. Simpson.)

termine is if in the circumstance we were discussing, a payment prior to maturity that there is necessarily a *debt* to the reserve account. I am asking, if instead of a debit the dealer might come and pay the bank in cash?

A. Generally when an account is paid off, either another dealer who has taken the car in trade or pays the car off, or the customer himself pays the car off, and the dealer doesn't know it is being paid off at all until he receives charge to his reserve account, then generally that is the first he knows.

Q. I will suggest something else: In the case of a default where there is a sum unpaid and uncollectible and [80] the dealer is liable to the bank as guarantor, now, the bank could either debit the dealer's reserve account or could demand a sum of cash from the dealer to make good his guarantee; is that correct?

A. In the case of a repossession, we would figure the same kind of a pay-off that you see on the blackboard. That is, No. 1, we would refund the unpaid portion of the charges, we would charge his reserve for his share and then we would have the net pay-off which we would take a dealer's check for.

Q. Supposing the dealer's credit reserve balance is not enough—not sufficient to take care of his portion, he could come in and pay off in cash?

A. Couldn't. That's another thing that just doesn't happen in a bank. We just don't let that happen.

(Testimony of Russell H. Simpson.)

Q. In your testimony you stated that the credit to the dealer's reserve does not represent a fund. With that the Government has no quarrel, but the Government wants to ask you this question: The credit to the dealer's reserve does represent a liability of the bank to the dealer, does it not?

A. Potential liability.

Mr. White: Would you repeat that answer, please? Will the reporter read it back?

(Record read.) [81]

Q. (By Mr. White): You injected the word "potential." Isn't it a fact that unless there is a default and the bank—the dealer does not make it good by payment in cash, unless the contract is not paid off——

A. There is a liability control by the bank. It isn't a direct liability by the bank. In other words, if there is a deposit reserve account with, say, a savings deposit or a checking account deposit, which is paid on demand, it differs from the reserve account because it is paid on demand and the reserve account is not payable on demand, a reserve account is not subject to Exhibit 2-B, something of that nature.

Q. Assuming the instance we have here where there has been a credit to the dealer's reserve of \$67.25, assuming there had been no other transactions with this dealer, that is the sole contract assigned and purchased by the bank, one moment after purchasing that contract the bank for some

(Testimony of Russell H. Simpson.)

reason of its own decides to forgive the purchaser and it does?

Let's assume the purchaser is no longer obligated to pay the bank, the bank forgives, and there is no further deal contemplated by the bank and the dealer cannot—the dealer insists the bank pay it \$67.25 at that moment?

A. For such an example, I wouldn't want to get into it. [82]

Q. I am trying to illustrate this point, Mr. Simpson: The \$67.25 is owed to the dealer by the bank and must be paid to the dealer unless certain things happen. For example, a default by the purchaser, a premature payment by the purchaser or the dealer enters into some kind of loan agreement with the bank and hasn't paid off. Unless those things happen, the dealer has to pay—the bank has to pay the dealer \$67.25 that it is obligated to pay?

A. The bank is obligated to pay \$67.25 to the dealer when one of two things happen: 1, the contract is paid off by the purchaser; 2, when the contract is paid off by the dealer. Then when the contract is paid off, it's paid off. In any event, that \$67.25 belongs to the dealer.

The Court: If any one of those things happens, you mean?

The Witness: Yes.

The Court: Very well. I think that is enough on that.

Q. (By Mr. White): Again I have to ask you



(Testimony of Russell H. Simpson.)

a question because some remark was made on direct that this reserve credit was subject to other computations before payment to the dealer.

Well, the Government contends that isn't necessarily so. There might be a default, but if the dealer comes and pays that default by direct cash payment, there is no need for [83] any computation to be made.

So I ask you that question: Is there necessarily a need for any computation before payment by the bank to the dealer immediately after a contract is assigned to the bank, assuming there is payment, say, by the purchaser, all you need do is determine what sum is no longer collectible under the time price differential and then the dealer says "I will have no further business with you. I am going to withdraw any further negotiations." You are obliged to pay him the \$67.25, less that portion of the unpaid time price differential?

A. I assume——

Mr. Hankins: Could we have that read back?

Mr. White: I will restate the question.

Mr. Hankins: It seems like that question got out of hand.

Q. (By Mr. White): We have this contract that you have credited to the dealer's reserve of \$67.25 and the same day the purchaser pays the contract in full. You would then debit the reserve with the portion of the time price differential which is no longer collectible, is that correct?

A. We would. That portion of the dealer's re-

(Testimony of Russell H. Simpson.)

serve would be part of the refund to the customer because of prepayment.

Q. All right. [84]

Assuming there is a balance in the credit, a balance in the dealer's reserve and the dealer says "I do not intend to sign any more contracts with you. I would like to terminate our dealings. Please refund my credit balance from the dealer's reserve." Are you obliged to refund him that credit balance?

A. We would refund to him any portion of that reserve that exceeded our 10 per cent requirement, less 35-day accounts, less repossessions.

Q. As interest is earned by the bank, is there any entry made to that dealer's reserve account?

A. As you put the question, no.

Q. So that it is possible that an entry—that an entire contract may be paid off and the full time price differential paid to the bank by the purchaser and there would still be no entry to the dealer's reserve account?

A. That is entirely possible.

Q. Under those circumstances, the bank would have reported as interest income from entire discount——

A. The bank discount, yes.

Q. I might also add that in addition there is no payment made by the bank to the dealer under those circumstances, no cash payment?

A. No. In this case, that \$67.25 would help the dealer build equity in his reserve so that whether he [85] exceeded his 10 per cent requirement, he could draw some money.

(Testimony of Russell H. Simpson.)

Q. Now, under those circumstances, the credit balance is not necessarily going to be in excess of 10 per cent of the remaining credit balances?

A. Not necessarily, but as I understand, the Government is trying to prove something here. Actually, when the dealer ceases his business, then there is contingent liability and set rates, these decreasing amounts—it is easy for the dealer to get equity in his reserve above the 10 per cent.

Q. In case you want to clarify yourself—your answer—I was trying to show in this particular contract the bank, which is on an accrual basis and the partnership which is on an accrual basis, in the case of the bank the entire time price differential which it receives as its portion would have been reported as interest income, so there has been full payment, but the partnership may not have reported any of this so-called interest as income under the circumstances I have outlined.

So my question is, again—correct me if I am wrong—is it not correct that in this particular instance where the time price differential is \$143.15, it is possible that the entire contract was paid, the entire time price differential was paid and the bank reports an interest income [86] of \$75.90, and at the same time there has been no payment to the dealer out of his dealer's reserve account?

A. No payment whatsoever. All payments to the dealer are based on his excess in his reserve account over our 10 per cent requirement.

Q. Is it correct that the dealer's reserve account

(Testimony of Russell H. Simpson.)

is subject not only to his liability as guarantor under the conditional sales contract, but also subject to any other liability he may incur with the bank?      A. Yes.

Q. For example, if he were to come to the bank and say "Loan me \$10,000" and the bank did so, his obligation to pay that \$10,000 would be—the dealer's reserve would be security for that obligation?

A. No, it would not be security for that at all, but it would be held in case of a problem with the borrower, we would probably hold the reserve.

Q. If he didn't pay the ten thousand at maturity, could the bank debit the dealer's reserve?

A. Yes, under the banker's right of offset.

The Court: That would be a right of offset, rather than a condition of the contract. That is not in the contract, is it?

The Witness: No.

Mr. White: I might clarify, your Honor. Exhibit 2-B states, and I will quote from paragraph 15: [87]

"Banks may retain from the proceeds of each contract purchase hereunto agreed upon amounts and the accumulated total of said amounts shall be retained by the bank in the dealer's reserve account as security for any and all obligations for dealer to bank."

The Court: I take it, then, the contract speaks for itself. You are speaking from memory and if

(Testimony of Russell H. Simpson.)

there is some provision there, you will change your testimony?

The Witness: Just what are we talking about here? Some of it I missed. As I remember, you were talking about unsecured loans of ten thousand dollars that wasn't paid. This agreement would not cover that.

Q. (By Mr. White): Then, would you explain why your answer, in light of paragraph 10, which states at that time the reserve, the security in the dealer's reserve account, is security for any and all obligations of dealer to bank?

A. Well, primarily that is referring—every major dealer, I do believe, in the used car business also has a flooring line in connection with the automobile business, so this contract would involve all the contracts that had been made by buying and selling automobiles, both floor and contracts—flooring and contracts.

Mr. White: No further questions, your Honor.

The Court: Any redirect examination?

Mr. Hankins: Your Honor, I would like to make a motion to strike all of the testimony of the witness dealing with the assumption that the dealer would bring in a large sum of money and deposit, which they could then or might charge against—to these charge-backs, instead of the way the bank handled it in this particular case.

The Court: Your ground is it is immaterial, irrelevant?



(Testimony of Russell H. Simpson.)

Mr. Hankins: Irrelevant and immaterial in this particular case.

The Court: You don't deny the competency of the witness to answer?

Mr. Hankins: It is something out of his purview, I would say, and it doesn't—he doesn't set down policies of the bank.

The Court: I understand that, however, I will deny the motion, it may have some bearing, may be of some help to the Court. I will determine whether it is material at a later date.

### Redirect Examination

Q. (By Mr. Hankins): Mr. Simpson, are you—are any dealers ever asked to put money into the reserve account? A. Not to my knowledge.

Q. If a dealer—Strike that.

If a party that is not a dealer brings a contract to your bank covering the sale of a car on a conditional sales contract, would you charge that non-dealer the same amount of the time price differential portion as you would a regular dealer?

A. We would charge a higher rate.

Q. A higher rate than you would charge the dealers? A. That's right.

Q. Generally why would you charge a higher rate than you would a dealer?

A. The dealer brings in contracts, brings his contracts in to us in certain volume, depending on the dealer, and he is entitled to more consideration rate-wise than the individual purchaser.

(Testimony of Russell H. Simpson.)

The Court: Because of the volume of business he brings you?

The Witness: That is right.

Q. (By Mr. Hankins): In other words, then, part of the consideration for his bringing these contracts to you is that you give him part of the finance charge that ordinarily you wouldn't have gotten from a non-dealer without sharing with the non-dealer?

Mr. White: Your Honor, counsel didn't want me— [91] restricted me in cross-examination, and I must insist he not put words in the witness' mouth.

The Court: I agree. Let counsel rephrase any question he wants to ask.

Q. (By Mr. Hankins): The non-dealer, then, if he brings a contract to you, would you not share in the time price differential?

Mr. White: I object, your Honor, the phrase "share"——

The Court: I agree with counsel for the respondent. You are asking the witness for a conclusion on the question, as I understand it.

The Court is going to have to pass on the question of whether they are sharing in something or whether the bank is making a charge and the taxpayer is making a charge.

Mr. Hankins: I will rephrase.

Q. If a non-dealer were to bring a contract to you at the same figures that we have above here on our typical transaction, would you give him any-

(Testimony of Russell H. Simpson.)

thing else for that contract over and above what your normal discount rate would be non-dealers?

A. By that contract, at our direction, direct bank rates to individual purchasers, which would be at 6 per cent, and there would be no other credits other than to your unearned discount. [91]

Q. In other words, you would not set up any portion or any reserve for this particular non-dealer? A. No reserve set up.

The Court: May I ask you this: Are you speaking now of a case where this particular individual came in and guaranteed the account to the bank, counsel?

Mr. Hankins: I might bring that out, your Honor.

The Court: If you will.

Q. (By Mr. Hankins): If a non-dealer were to bring to you a contract similar to, with the same identical figures on it as we have on our typical transaction, would you ask him to guarantee that paper?

A. When this person referred to as a non-dealer, would he be other than the purchaser of the contract?

Q. One other than the purchaser.

A. The purchaser of the automobile?

Q. One other than the purchaser of the automobile.

A. No. If another dealer who was not on our books under a dealer's agreement, dealer's reserve, brought us a contract, first of all, we wouldn't take

(Testimony of Russell H. Simpson.)

his contract, we would tell him we would buy the paper if the customer would come in with his order and then we would write the contract from our bank at our rate of interest to a consumer.

Q. And would that rate of interest be greater than [92] you charge to dealers?

A. Yes, it would.

Mr. Hankins: That is all, your Honor.

Mr. White: No further questions, your Honor.

The Court: Thank you, Mr. Simpson.

(Witness excused.)

Mr. Hankins: I would like to call one other witness, your Honor, the petitioner in this action.

### ARTHUR V. MORGAN

called as a witness on his own behalf, being first duly sworn, testified as follows:

#### Direct Examination

Q. (By Mr. Hankins): Mr. Morgan, are you the petitioner in this action? A. I am.

Q. Were you a partner in the Art Morgan Motor Company partnership in Long Beach?

A. I am.

Q. During the year 1950 did you arrange with the Farmers & Merchants Bank to assign to them various conditional sales contracts covering the retail sale of used cars?

A. I believe I arranged for that in 1946, which extended through a period of 1950.

Q. What was the purpose in arranging this

(Testimony of Arthur V. Morgan.)

financing with the bank, Mr. Morgan? [93]

A. Well, to sell contracts to them.

Q. Was it for the purpose of facilitating sale of your automobiles?

A. I had to have financing or I couldn't operate. In other words, it was to carry on my business.

Q. When these conditional sales contracts were entered into covering the sale of these used automobiles, were they made subject to credit approval?

A. They were.

Q. And who checked the credit?

A. That I don't know, some official in the bank.

Q. The bank did it?

A. The bank did it, yes.

Q. Then, after the bank checked the credit and okayed it, you completed the sale, is that the way it was handled?

A. The sale would be completed when they okayed the contract.

Q. Generally how soon after the purchaser agreed to buy this car, and the paperwork was completed on the purchase in your office, was it before you assigned it to the bank, Mr. Morgan?

A. Well, conditions varied there. We would have a purchaser that would make a—say, give \$100 down payment and sign a contract and all the necessary papers, and then we would hold the contract until he brought in his additional [94] down payment, and then we would take it to the bank. Some would even come back and go through a



(Testimony of Arthur V. Morgan.)

credit union or their own bank, or something, and pay us in full. But that would vary, too, in the time that he signed the contract and the time that the contract reached the bank, that would depend on how quickly he completed his down payment.

Q. Mr. Morgan, how long have you been in the used car business?

A. Well, I started—I believe in December, 1946, the first time—I mean the last time, pardon me.

Q. Has your income tax return for any previous year ever been examined?

A. They have by the agents. In fact, I was examined in '47 and, I believe, in '49, and they went to the bank, I believe, the investigators then. The first one was named Harris and the last one was named Greenberg. And if I hadn't drawn out any excess reserve by the end of the year, I had to pay on it.

Q. In other words, in some of those previous years, I gather the same issue arose as to the dealer's finance reserve?

Mr. White: I object to this. I don't see the purpose of what happened in prior years. The Government might, for the purpose of argument, concede the agents didn't do their job, I see no purpose in this testimony. [95]

The Court: I don't think it has any bearing. Of course, the Court is concerned in the proper answer as to whether the Government or the taxpayer might have made a mistake, but something in prior years isn't of too much concern here.

(Testimony of Arthur V. Morgan.)

The Witness: Your Honor, may I say one word?

The Court: Let your counsel.

Mr. Hankins: Your Honor, the purpose actually is somewhat of an equitable situation. I think in this case if I may explain to the Court, in prior years this man was examined and this same thing was in issue. He spent some time going over it with the agents, two of them, in fact, and finally agreed with them that he would pay on his income, in this particular matter, of setting up into income the excess of the dealer's finance reserve over the 10 per cent limitation which he agreed was available as a constructive receipt.

The Court: I take it, the Government is now saying that that is not proper.

Mr. Hankins: They are now taking an adverse position and the taxpayer has been put in quite a burdensome situation in trying to go back and re-vamp some of these years. If the Government takes this attitude, establishes it is going to be adverse, take an adverse stand on some of the years, we will not then get the benefit for some of the years [96] that have elapsed in the meantime, and by handling it in this particular manner, due to some net operating losses, carry-backs involved in the situation, and I think that some as far as equitable issues are concerned, I think it is relevant.

The Court: I don't know just any equitable questions raised in the case. As I understand, the Government is claiming there is only one way to

(Testimony of Arthur V. Morgan.)

do this here, that the way you described it, the taxpayer—what the taxpayer did was wrong, and that is the issue before the Court.

Now, if there aren't any issues raised by the pleadings for any other years, all I can say is I guess it is my duty to decide what is right for this year.

As you know, taxable years are separate under Supreme Court decision, and it is possible that the Government might have been wrong in those other years, or it might have been a concession. On the other hand, the taxpayer may have been right in those years, I am not prepared to say at this moment, but I don't think what was done in prior years will influence the Court here in determining the proper answer for this year.

Now, if there is some complications that arise as a result of the decision of the Court, perhaps the parties can get together and try to iron out the difference, if there [97] are any duplications or anything of that nature.

Would there be any, counsel?

Mr. White: I know of none, your Honor. I think this is the first time I have heard of this equitable argument.

Mr. Hankins: Not in the pleadings, your Honor. My main purpose in getting this before the Court, generally the Tax Court never sits as an equity court, and I think your higher courts do and if the decision is in the Government's favor, then we would like to interject this in our appeal. So that

(Testimony of Arthur V. Morgan.)

is the reason I want to get the issue in. If you rule it out——

The Court: I am putting it in for whatever it might be worth, I am merely saying that as far as this Court is concerned, I don't see how it will affect our decision.

Now, have you asked all the questions you want to on that subject? There is that motion to strike—is that a motion from the Government's counsel or what?

Mr. White: I make a motion, your Honor, to strike any testimony regarding what any agent did in prior years in auditing returns of Mr. Morgan or any partnership which he was a member of.

The Court: Well, it is already in evidence now. I will deny the motion to strike, although, I must say at the moment I fail to see any relevance, but that is something that [98] can be decided later when the case is decided.

Mr. Hankins: I will ask one other question.

Q. As a result of prior examination in prior years in which this was an issue, what method did the agent use at that time to tax the dealer's finance reserve as income? Do you know, Mr. Morgan?

A. They checked directly with the bank to determine whether I could draw anything over the 10 per cent plus the bad accounts.

Q. Then, the excess they then determined was tax income to you? A. That's right.

Q. Did you agree to that? A. I did.

Q. Did you pay your tax? A. I did.

(Testimony of Arthur V. Morgan.)

Mr. Hankins: No further questions.

The Court: Cross-examination?

Mr. White: No questions, your Honor.

(Witness excused.)

Mr. Hankins: Your Honor, may we have permission to submit consecutive briefs in this?

The Court: Off the record.

(Discussion off the record.)

The Court: On the record. [99]

Is it agreeable to counsel to submit seriatim briefs?

Mr. White: That is agreeable.

The Court: What time would you like?

Mr. Hankins: Forty-five days would be sufficient, sir. I would like permission to file first.

Mr. White: I would like thirty days after the forty-five.

The Court: And you want time for reply briefs, do you?

Mr. Hankins: Yes, sir, I would like thirty days, if possible.

The Court: Very well. Forty-five days for the taxpayer's brief, thirty days thereafter for the respondent's brief and thirty days thereafter for the petitioner's reply brief.

The case will stand submitted awaiting filing of briefs.

The Clerk: Those days, gentlemen, are February 25, and thirty days thereafter will be March 27, and thirty days thereafter will be April 26, 1957.



(Whereupon, the hearing in the above-entitled case was closed.) [100]

[Endorsed]: T.C.U.S. Filed Feb. 1, 1957.

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[Endorsed]: No. 15898. United States Court of Appeals for the Ninth Circuit. Arthur V. Morgan and Dorothy O. Morgan, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: February 11, 1958.

Docketed: February 21, 1958.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for  
the Ninth Circuit.



2. The Tax Court erred in entering its order and decision that there is a deficiency in petitioners income tax for the Calendar year 1950 in the amount of \$4,076.40.

3. The Tax Court erred in that its decision is not supported by the evidence.

4. The Tax Court erred in that its decision is contrary to the law.

/s/ LEONARD B. HANKINS,  
Attorney for Petitioners on  
Review.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed February 21, 1958. Paul P. O'Brien, Clerk.

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[Title of Court of Appeals and Cause.]

## DESIGNATION OF CONTENTS OF RECORD ON REVIEW

To the Clerk of the United States Court of Appeals for the Ninth Circuit:

The following is a designation of the Contents of the Record in the above proceeding which is necessary and material to the Consideration of the review of the United States Tax Court Decision in this matter which is being appealed to your Court.

1. Docket entries in this proceeding;

2. Petition.
3. Answer.
4. Stipulation of Facts with Exhibits 1-A through 6-F attached;
5. Official Report of Proceedings before the U. S. Tax Court;
6. Findings of Fact and Opinion of the U. S. Tax Court;
7. Decision of the U. S. Tax Court;
8. Petition for Review of the U. S. Tax Court Decision;
9. Proof of Service of Petition for Review;
10. Designation of Contents of Record on Review;
11. This Designation of Contents of Record on Review.

/s/ LEONARD B. HANKINS,  
Attorney for Petitioners on  
Review.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed February 21, 1958. Paul P. O'Brien, Clerk.





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No. 15898

United States  
Court of Appeals  
for the Ninth Circuit.

ARTHUR V. MORGAN and DOROTHY O. MORGAN,

Petitioners,

-vs-

COMMISSIONER OF INTERNAL REVENUE

Respondent.

PETITION TO REVIEW A DECISION OF THE TAX COURT  
OF THE UNITED STATES

BRIEF FOR THE PETITIONERS

FILED

NOV 5 1958

PAUL M. GORDEN, CLERK

LEONARD B. HANKINS  
4014 Long Beach Blvd.  
Long Beach 7, California  
Attorney for Petitioners.



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No. 15898

**United States**  
**Court of Appeals**  
for the Ninth Circuit.

ARTHUR V. MORGAN and DOROTHY O. MORGAN,

Petitioners,

-VS-

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION TO REVIEW A DECISION OF THE TAX COURT  
OF THE UNITED STATES

JURISDICTION

This appeal by ARTHUR V. MORGAN and his Wife, DOROTHY O. MORGAN is taken from the decision of the Tax Court of the United States (Arthur V. Morgan and Dorothy O. Morgan, Petitioners vs. Commissioner of Internal Revenue, Respondent - Docket No. 56621, filed October 17, 1957; Cited 29 T. C. No. 9), which held that there is a deficiency in income tax for the





calendar year 1950 in the amount of \$4,076.40. The petition for review was filed January 7, 1958 (R. 38). Jurisdiction is conferred on this court by Section 7482 of the Internal Revenue Code of 1954.

## STATEMENT OF CASE

### History of Case

This action was brought in the Tax Court of the United States by Arthur V. Morgan and his Wife, Dorothy O. Morgan, against the Commissioner of Internal Revenue seeking a redetermination of an income tax deficiency by the Commissioner against taxpayer for the calendar year 1950.

The case was heard before the Tax Court of the United States at Los Angeles, California, before the Honorable Craig S. Atkins on January 11, 1957, on a stipulation of facts as well as oral testimony.

The Tax Court rendered its findings of fact and opinion on October 17, 1957, upholding the deficiency determined by the commissioner. The decision of the Tax Court was entered on October 17, 1957.

It is from this Opinion and Decision that this Appeal is taken.

### QUESTION PRESENTED

The assignments of errors contained in the Petition for Review raised primarily the following question:

Is that portion of the interest which a purchaser



of an automobile under a conditional sales contract agrees to pay according to its express and implied terms and which portion the bank agrees to pay to the automobile dealer who sold the car as consideration for guaranteeing the obligations of the purchaser as well as further consideration for selling the conditional sales contract to the bank and which sums the bank agrees to pay to the dealer is determined under a complicated formula and cannot be determined until after collections have been made on the contracts for some period of time, income to an accrual basis taxpayer at the time the conditional sales contract is assigned, transferred or pledged to the bank, or is it income at the time the sum of money payable by the bank to the dealer is determinable and payable to the dealer?

#### RESUME OF FACTS

The petitioners are husband and wife, residing at Long Beach, California. Their joint income tax return for the year 1950 was filed with the Collector of Internal Revenue for the Sixth District of California. The Petitioner, Arthur V. Morgan, will hereinafter be referred to as dealer or taxpayer (R. 20).

The taxpayer and Frank D. Lortscher formed a partnership doing business as ART MORGAN MOTOR COMPANY (hereinafter referred to as the partnership) in Long Beach, California on January 7, 1950. Taxpayer held a



75 percent interest and Lortscher held a 25 percent interest. The partnership kept its books and records on an accrual method of accounting. It filed its income tax returns for the taxable period January 7, 1950 to December 31, 1950, with the Collector of Internal Revenue for the Sixth District of California (R. 20-21).

The partnership was actively engaged in the purchase and retail sale of used automobiles. A large number of automobiles were sold under conditional sales contracts. In all such sales the conditional sales contracts were simultaneously assigned by the partnership to Farmers & Merchants Bank, Long Beach, California, hereinafter referred to as the bank. (R. 21)

The forms used in the making of conditional sales were furnished by the bank to the partnership. In all conditional sales contracts purchasers agreed to pay the amount designated therein as the "Contract Balance", which is made up of the several items set forth in the example given below. The purchaser agreed to pay the amount of the contract balance in equal successive monthly installments at an office of the bank. The contracts provided that title to the car should remain in the dealer until all payments were made and all conditions of the contract were complied with. Two forms of assignment were used by the partnership in assigning the contracts





to the bank. Under one form the assignment was made "with recourse" and the other was made "without recourse". (R.21)

From January 7, 1950 to July 1, 1950, the partnership assigned contracts to the bank under the form which bore the caption "with Recourse" and from July, 1950 until the end of the year it assigned contracts under the form designated "Without Recourse". (R. 21). However, the form of assignment which provided "Without Recourse" was supplemented with a form of agreement providing that the dealer would nevertheless guarantee the contract. The dealer guarantees all the paper assigned to the bank. (R. 71)

From January 7, 1950 to July 1, 1950, the partnership assigned numerous contracts to the bank under these forms of agreements. (R. 21-22)

The following example is typical, except for the amounts of the conditional sales contracts entered into between the partnership and the purchasers of used cars during the year 1950:

1. Cash Purchase Price	\$ 2,795.00
2. Sales Tax	83.85
3. Total Cash Purchase Price	2,878.85
4. Less: Down-payment	<u>1,645.85</u>
5. Unpaid Cash Purchase Price	1,233.00
6. Add: Motor Vehicle Tax	<u>40.00</u>
7. Unpaid Balance	\$ 1,273.00
8. Add: Time Price Differential (Finance Charges or Interest)	<u>143.15</u>
9. Contract Balance	\$1,416.15



Upon assignment of a contract containing the figures in the example above set out, the bank would immediately pay to the partnership the amount of \$1,233.00 shown as Item 5 and designated "Unpaid Cash Purchase Price". Item 6 in the amount of \$40.00 representing motor vehicle tax, would be paid by the bank either to the partnership or directly to the Department of Motor Vehicles depending upon whether the partnership or the bank cleared the title to the car. Item 8, designated as "Time Price Differential" consisted of finance charges or interest, and was variable depending upon what the partnership saw fit to charge the purchaser. (R. 23-24). The remainder of the time price differential would be credited to the dealer's reserve account. In the example the "Time Price Differential" of \$143.15 would be divided as follows:

1. \$75.90 to the bank of which the bank would take \$5.00 as earned discount and \$70.90 as unearned interest.
2. \$67.25 credited to a dealer's reserve account.  
(R. 54-55).

The entries in the dealer's reserve account on the books of the bank were recorded by the partnership in a memorandum account. The partnership did not record such entries in a general ledger account nor did it reflect them in any of its financial statements. The bank informed





the partnership of entries made in the reserve account and periodically sent the partnership statements showing the balance in such account. (R. 25).

During the year 1950 some of the purchasers under contracts which the partnership had assigned to the bank paid off the contracts prior to their normal maturity dates and accordingly under the applicable state law were not obligated to pay the entire sum designated "Time Price Differential", but only a lessor sum. In these circumstances, the bank debited the reserve account for the portion of the sum that was no longer due from the purchaser. (R. 25-26)

In the above example of a 15-month contract, if the purchaser paid up the contract in six months, the bank would reduce the amount of the time price differential by the sum of \$44.20 of which \$22.83 would be entered in its unearned discount account and \$21.37 would be charged to the dealer's reserve account. (R. 27).

The following schedule sets forth, with respect to some of the contracts assigned by the partnership to the bank, the date and amount of the original credits by the bank to the reserve account, and the dates and amounts of the debits to such account in instances of prepayments by the purchasers of cars:



Name of Car <u>Purchaser</u>	Credits to Reserve Account		Debits to Reserve Account	
	<u>Date</u>	<u>Amount</u>	<u>Date</u>	<u>Amount</u>
Finley	1/21/50	29.90	2/17/50	19.90
Williams	3/27/50	15.40	6/ 3/50	2.20
Barker	6/ 1/50	106.00	7/15/50	88.32
McConnell	5/27/50	49.35	7/20/50	30.00
Barrett	6/20/50	52.24	6/29/50	52.24
Welch	4/14/50	84.21	8/10/50	56.01
Van Meter	7/14/50	50.80	8/16/50	37.53
Kennedy	8/ 2/50	107.57	8/18/50	94.37
Schuler	8/ 4/50	211.55	8/29/50	153.40

The above schedule is merely illustrative and does not set forth all instances where prepayments were made by purchasers. (R. 27).

In determining whether a dealer was entitled to withdraw any amount from the reserve account, the bank deducted from the amount of the reserve the full amount of the partnership's recourse liability on any delinquent accounts and repossession. During the year 1950, the credit balance in the reserve account of the Art Morgan Motor Company, reduced on account of delinquencies and repossessions, never exceeded ten percent of the aggregate unpaid balances of the contracts that has been assigned by the partnership to the bank. The partnership was not entitled to receive and the bank was not required to make and did not make any payments to the partnership in pursuance of the terms of the agreement. At all times



material the bank was financially sound and was able to pay any amount due to the partnership. (R. 27-28).

During the taxable year the credits to the reserve account totaled \$16,895.08 and the debits thereto totaled \$1,130.76, leaving a credit balance of \$15,764.32 at the end of the year. (R. 28).

The partnership did not report as income for the period in question any of the credits to the reserve account or any of the \$15,764.32 credit balance therein; nor did it report any of the debits as a deduction. The partnership did not claim a bad debt deduction for the taxable year in question. (R. 28).

In determining the deficiency, the respondent increased the partnership's income for the taxable year 1950 by the sum of \$15,764.32, representing the credit balance in the reserve account as of the end of the taxable period 1950, and as a consequence increased the petitioner's distributive share of the income of the partnership. The respondent also held that the \$15,764.32 item did not constitute a deductible item to the partnership under any provision of the Internal Revenue Code of 1939. (R. 28-29).

#### SPECIFICATIONS OF ERRORS

1. The Tax Court erred in that it held that amounts retained by the bank as purchaser of an automobile





dealer's deferred payment contracts and credited to a reserve account on the books of the bank to be accruable income to the dealer in the year of the sale of the contracts even though the amounts of the reserve at the close of the year was not sufficient to allow the dealer to demand payment of any part thereof.

2. The Tax Court erred in entering its order and decision that there is a deficiency in petitioner's income tax for the calendar year 1950 in the amount of \$4,076.40 or in any other amount.

3. The Tax Court erred in that its decision is not supported by the evidence.

4. The Tax Court erred in that its decision is contrary to law.

### ARGUMENT

#### RESUME OF ARGUMENT

The bank in addition to paying the dealer the cash balance due on a conditional sales contract, agreed to share with the dealer part of the interest as it was earned under specific terms and conditions in consideration for the dealer guaranteeing that the conditional sales contract would be performed according to its terms. Since the amount of this unearned interest which the bank had agreed to share with the dealer could not be determined until the happening of certain contingencies which



did not occur during the taxable year in issue and since the dealer under the terms of the contract with the bank had no right to receive any amount of the interest, there has been no income to the dealer from such interest during the year in issue.

### ARGUMENT

Before the ultimate decision can be determined by this Court, consideration is going to have to be given to secondary issues presented in this case. These secondary issues which the court must consider are as follows:

1. What is gross income?
2. When does income accrue?

We will consider these secondary issues in the order mentioned.

FIRST: It is necessary for us to determine whether, under the rules of taxation which have been laid down by Statutory and Case Law, the amounts which the commissioner has determined that should be added to the petitioner's taxable income is actually gross income and taxable under the law applicable thereto.

Section 22(a) of the Internal Revenue Code of 1939 defines gross income to include "gains, profits, and income" derived from a long list of sources mentioned and then ends by including in gross income "gains or profits and income derived from any source whatever". This





section in effect, includes in gross income all items that are constitutionally income and that are not excluded by the provisions of some other section.

The Supreme Court of the United States in the case of EISNER v MACOMBER 252 U.S. 189, 40 S. Ct. 189, stated that income is that gain which is "---received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal....". In the instant case the amounts which the commissioner has attempted to add to the income of taxpayers, represents mere bookkeeping entries upon the books and records of the bank. (R. 17, 18, 58, 68, 69, 109). These sums do not reflect a true liability of that bank to the taxpayer. (R. 109). They are merely entries made by the bank in order that after certain additions and subtractions are made (which items may or may not occur) the resulting balance may or may not reflect a liability to the dealer, since it cannot be determined whether or not there will be any liability to the dealer until after subsequent events occur. (R. 16, 53, 69). These mere bookkeeping entries do not come within the definition statutory or by case law of gross income. Therefore, since this issue must be answered in the negative, the commissioner has erred in taxing these amounts to the taxpayer and the Tax Court likewise has erred in sustaining the commissioner's position. However, assuming



for purposes of argument only, that these amounts of bookkeeping entries are gross income within the purview of the law, we then must consider the next question.

SECOND: Our next secondary issue which must be determined is: Assuming that the commissioner has correctly determined that the amounts represent gross income of the taxpayer, then in what year is the taxpayer required to report the same as income when the taxpayer is on the accrual method of accounting? That is, when does income accrue when the money has not been received by the taxpayer?

In the case of H. LIEBES AND SEAL v CIR 90 F. 2nd 932, 936 (9 CCA 1936) it was stated the "Act (Internal Revenue Code) does not define nor provide when income accrues". Therefore, we must look then to the court decisions in order to determine how and when items of gross income accrues in order that we may determine the year of taxability of such income.

In LUCAS v NORTH TEXAS LUMBER CO., 281 U.S. 11, 50 S. Ct. 184, the Supreme Court held that income does not accrue until there is an unconditional liability of someone to pay it to the taxpayer. In the instant case there certainly was a conditional liability upon the bank to pay any of the time price differential to the dealer because of the numerous contingencies which until the events



occurred, there was no liability upon the bank to pay. (R. 16, 53, 69). These contingencies involved (1) the payment of the interest or time price differential by the purchaser to the bank (2) whether the total unearned interest as set forth on the contract would be reduced because the California law requires that the total unearned interest to be reduced in case of prepayment which in case the contract is paid before its regular maturity date; (3) the contingency of the dealer fulfilling his guarantee of the contract; (4) pay-offs due to repossessions which would reduce the amount payable as interest to the bank; (5) the contingency of the total outstanding contracts being less than 10% of the net sums of the remaining balance in the so called reserve account. (R. 16, 53, 69). Since all of these were contingencies, the mere bookkeeping entries made by the bank on its books certainly is not an unconditional liability of the bank to the dealer at the time it is made; therefore, there is no accrual until there is that unconditional liability which would only come about at the time when under the contract with the bank there is this unconditional liability to pay a sum certain. In this case it is of importance to notice that in the stipulation of facts (R. 17) that the total additions to the dealer reserve account on the contracts represented therein equals to \$707.02 and that





the dealer's share of this original computed interest was reduced by \$533.97 due to payoff's on these contracts prior to the maturity date. This is a 75.5% reduction from the original share allocated to the dealer by the bank in its first allocation of the unearned interest. Certainly this great percentage in reduction shows that it is impossible to determine within any reasonable certainty what, if anything, the dealer is entitled to receive and therefore no amounts should be accruable as income until this can be determined.

The Supreme Court in the case of CONTINENTAL TIE & LUMBER CO., v U. S. 286, U. S. 290, 52 S. Ct. 529, held that income accrues when there is a right to payment. In the instant case there was certainly no right to any payment by the taxpayer during the year 1950 nor was there any duty on the part of the bank during this year to make any such payment. Neither did the taxpayer have an unqualified contractual right in the taxable year to demand or receive any of the amounts which the commissioner has determined to be income of the dealer (R. 28). Of the total which the commissioner has determined to be income of the taxpayer there is no way to determine what portions of these amounts, if any, would ultimately be received by the taxpayer.



U. S. 417, 424; 52 S. Ct. 613, 615, the Supreme Court said:

"If a taxpayer received earnings under a claim of right and without restrictions as to his disposition he has received income which he is required to return even though it may still be claimed that he is not entitled to retain the money and even though he may still be adjudged liable to restore its equivalent."

In the instant case the taxpayer has received no moneys under a claim of right during the year in question. In fact, under the agreement between the taxpayer and the bank he had no claim of right to any portion until the share of the interest agreed to be paid to him from each contract exceeded 10% of the outstanding liabilities of all contracts and not until that contingency occurs, could it be said that the taxpayer had a claim of right to any sums of money.

The Supreme Court in the case of SPRING CITY FOUNDRY CO. v CIR 292, U. S. 182, 184, 54 S. Ct. 644, 645 in discussing the problem of accrual of income and as to the problem when it accrues stated as follows:

"Keeping accounts and making returns on the accrual basis as distinguished from the cash basis, imports that it is the right to receive and not the actual receipt that determined the inclusion of the amount in gross income. When the right to receive an amount becomes fixed the right accrues."





Again the taxpayer having no right to receive any sums of money from the bank for the simple reason that it could not in any way be determined what if any would ever be paid by the bank to the dealer as compensation for guaranteeing the notes, there should be no accrual to the taxpayer of any income during the taxable year 1950.

In cases wherein sums of money may be payable but are dependent upon contingencies whereby the taxpayer may never in the future ever receive those funds no sums are reportable as income until the sums can be adequately determined. This is so held in the case of CIR. vs. CLEVELAND TRINIDAD PAVING CO. 62 F. 2d 85, affirming 20 BTA 772. The court stated in essence that a taxpayer on the accrual basis is not required to include in income sums to be received in the future where there is a substantial contingency as to the amount to be received or the time of its receipt. In LYNCHBURG TRUST AND SAVINGS BANK v CIR. 68 F. 2d 356, CERT. DEN. 292 U. S. 640 the Court stated:

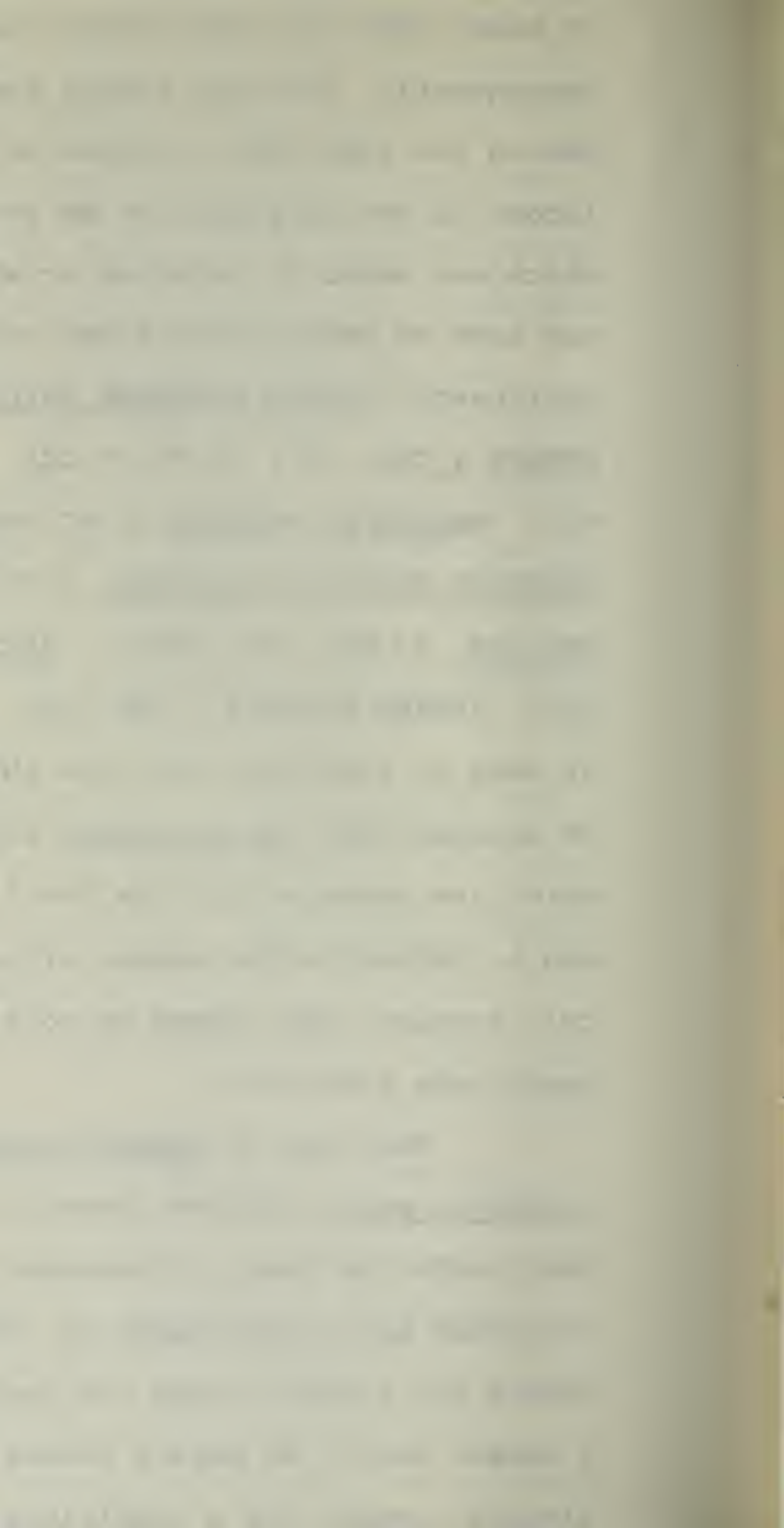
"Taxpayers generally are charged with income not reduced to possession, but only if it may be said that the income is received constructively and has become so far subject to the taxpayers demand that its non-receipt is a matter of his own choice".

In the instant case it cannot be said that the taxpayer has constructively received any income for the simple reason he did not have the right to demand any sum



of money from the bank during the year in question and consequently for that reason the income is not accruable during the year 1950. Courts have continually held that income is not accruable to an accrual basis taxpayer which may never be received or where the taxpayer does not have an unqualified right until the happening of some contingency (GREAT NORTHERN RAILWAY CO. 8 BTA 225; STONER v CIR. 79 F 2d 75 (3 CCA 1935 CERT. DEN. 296 U.S. 65); MARION H. McARDLE 11 TC 960 (1948); ESTATE OF MARGARET McALLEN FAIRBANKS, 3 TC 260 (1944); E. P. MADIGAN, 43 BTA 549 (1941); SARAH R. PRESTON, 35 BTA 312; SEWARD PROSSER 7 BTA 734). From these cases it is easy to formulate the rule that an item of income shall be accrued when but not until all events have occurred which are necessary to fix the liabilities of the parties and to determine the amount of such liabilities. This rule requires that there be no remaining unsatisfied conditions precedent.

The case of COMMISSIONER OF INTERNAL REVENUE v HANSEN, et al and the companion cases, 360 U.S. 466, dealt with the issue of accruability of income to a dealer from what has become known as "dealer's reserve". In the HANSEN and related cases the factual situation was that a dealer was to be paid a certain sum of money by the finance company for a conditional sales contract assigned





by the dealer to the finance company. The finance company then would withhold 5% of the sales price, give the dealer 95% and place the 5% into a "dealer's reserve" account. Thus, in these cases a sum of money was withheld from the sales price. However, in the case now before the court, we have an entirely different situation and completely distinguishable by its facts. In the instant case, there was nothing withheld from the sales price given the dealer. The facts show that the dealer assigned, transferred or pledged the paper to the bank and the bank gave the dealer the balance of the cash price (R. 24) except in certain instances when the bank did not believe the contract balance after the cash payment by the purchaser was sufficient (R. 69, 70, 83). In these latter instances the bank would withhold certain sums from the dealer pending final reduction in the account by the purchaser at which time the bank would release these withholds to the dealer (R. 69, 70 , 83, 84). These withholds are not in issue in this case. In the case now before the court the bank, in addition to paying the dealer the cash balance of the purchase price of the car for the paper from which there was nothing withheld, agreed to share part of the interest as it was earned with the dealer under specific terms and conditions in exchange for the dealer guaranteeing the





purchaser's liability to the bank.

From the following testimony which appears in the record, it is apparent that the bank agreed to share with the dealer (taxpayer) part of the interest charge on the contract in exchange for the dealer bringing his conditional sales contract to the bank and as consideration for the dealer guaranteeing the conditional sales contract:

Findings of the Court: "Purpose of the bank in maintaining the dealer's reserve account were to provide security for the payment of the assigned contracts and to induce the dealer to discount contracts with it". (R. 25)

Q: Mr. Simpson, do you know whether or not the purpose in setting up this dealer's reserve account for the dealer is for the purpose of getting the dealer to guarantee the paper to the bank?

A: Yes, I know. (R. 71).

Q: Would you state whether it is or not for the purposes of securing the guarantee by the bank of the paper which is assigned by the dealer to the bank?

A: I would say it is one of the reasons. (R. 71,72) Again from Pages 77-79 of the Record where the witness from the bank to whom the taxpayer sold its conditional sales contracts was under rigid cross-



examination by the Government Attorney, the attorney was attempting to determine from the witness what would happen if there was no unearned interest (time price differential) added to the contract with which to split with the dealer and the witness at the bottom of Page 79 and top of 80 of the Record replied as follows:

"We would not be able to ask the dealer to sign the contract "with recourse", therefore, it would become a direct bank deal, there would be no liability on the part of the dealer on the occasion of repossession or default."

From page 93 from the same line of questioning by the Government Attorney, the witness gave the following answer:

"-----I have never known a dealer to guarantee a contract unless he got paid something in his dealer's reserve account and as I think I mentioned before, if we bought such a contract it would have to be on a direct bank deal, it could not be guaranteed by the dealer, it would be the bank's deal with the purchaser and then we would consider a direct bank loan and we would not charge four and one-half percent, we would charge six percent".

From the record on pages 116-119, appears the following pertinent testimony:

Q: If a party not a dealer brings in a contract to your bank covering the sale of a car on a conditional sales contract, would you charge that non-dealer the same amount of the time





price differential portion as you would a regular dealer? (R. 116).

A: We would charge a higher rate.

Q: Generally why would you charge a higher rate than you would a dealer? (R. 116)?

A: The dealer brings contracts into us in certain volume, depending on the dealer, and he is entitled to more consideration ratewise than the individual purchaser. (R. 116).

Q: If a non-dealer were to bring in a contract to you at the same figures that we have above here on our typical transaction (this was referring to a typical sales contract given by stipulation on R. 16) would you give him anything else for the contract over and above what your normal discount rate would be non-dealer? (R. 117-118)

A: By that contract at our direction, direct bank rates to individual purchasers which would be at six percent and there would be no other credits than to your unearned discount (R. 118).

Q: In other words you would not set up any portion of any reserve for this particular non-dealer? (R. 118).

A: No reserve set up (R. 118).

Q: If a non-dealer were to bring you a contract similar to the same identical figures on it as we have on our typical transaction would you ask him to guarantee that paper? (R. 118).

A: No if another dealer who was not on our books under a dealer agreement, dealer's reserve,



brought us a contract, first of all we would not take his contract, we would tell him we would buy the paper if the customer would come in with his order and then we would write the contract from our bank at our rate of interest to a customer. (R. 118-119).

Q: And would that rate of interest be greater than you charge to dealers? (R. 119).

A: Yes, it would. (R. 119).

Q: The reserve account, what is the purpose of the account? (R. 84).

A: To induce the dealer to discount contracts with us, Sir: (R. 84).

Q: And it is to secure the bank? (R. 84).

A: So far as the bank is concerned it is a method of getting business. (R. 84).

The following testimony discloses that this case is different from the HANSEN, et al cases in that when the bank purchased the paper, the bank paid the cash balance (Item 7 of Stipulation of a Typical Transaction R. 16) and did not withhold anything from the dealer.

Q: The contract balance is.....to be exact \$1,416.16. Now, then the dealer comes in and asks if you will handle this contract, Mr. Simpson, you would purchase it for the sum, less the bank's normal discount? (R.85,8

A: No. (R. 86)

Q: What sum would you purchase it for? (R. 86)



A: We purchased for Item 7, the unpaid balance.  
(Note here witness is referring to Item 7  
on the Stipulation of Typical Transaction R.  
16 of \$1,273.00). (R. 86)

Q: Lets run through on that. You would pay  
\$1,273.00 in cash to the dealer? (R. 86)

A: Yes.----- (R. 86)

The following testimony discloses the method used  
by the bank and the dealer to determine what if anything  
the dealer will eventually get as his share of the  
interest:

Q: Would you describe the procedures used by the  
bank in handling that amount? (Note this  
refers to the \$143.15 time price differential  
interest which appears as Item 8 on the Typical  
Transaction set out in the Record on Page 16).  
(R. 54).

A: We would arrive at a charge determined by the  
rate that we were charging the dealer and  
would take the charge and subtract it from the  
time price differential on Line 7 - on Line 8  
and credit the balance to the dealer's reserve  
account. (R. 54)

Q: Have you made a breakdown of those figures,  
the computation that the bank makes for this  
\$143.15? (R. 54).

A: Yes, I have.

Q: What is the breakdown that you have computed?  
(R. 54)





- A: The bank charges would be \$75.90 and there would be credited to the dealers account, \$67.25 to the dealer's reserve account. (R. 54).
- Q: If this contract had been paid off after six payments, would the bank make any adjustments in its records? (R. 56)
- A: Yes. (R. 56)
- Q: Assuming that this contract was a fifteen month contract and it was paid off in six months, have you made any computation to show what adjustments the bank would have made on its records?
- A: Yes, I have.
- Q: What are those? (R. 56)
- A: There would be a refund of unearned charges in the amount of \$44.20. (R. 56)
- Q: What else does the bank do? (R. 56)
- A: Since the bank has refunded charges it had previously collected they can split up that refund between that portion of the refund that the bank would charge itself and that portion that they would charge to the dealers reserve account. (R. 56).
- Q: Have you made the computations of what figures would be represented? (R. 56)
- A: Yes, in this particular case, \$21.37 would have been charged to the dealer's reserve account and \$22.83 to the bank unearned discount. (R. 56-57)



THE COURT: That means that you would have earned that much less than you thought you would earn? (R. 57)

THE WITNESS: Right (R. 57)

Q: Then the dealer would lose or his earnings would be \$21.37 less than the original share? (R. 57)

A: Thats right. (R. 57)

Q: Is this \$67.25 that you put into this dealer's reserve account, is that subject to the dealer's withdrawal immediately? (R. 57)

A: The dealer has no control over the account whatever. (R. 58)

Q: In essence, then you take your time price differential and the dealer and the bank shares in that? (R. 58)

A: Thats right. (R. 58)

Q: In other words, this original \$67.25 of the time price differential which you put into the dealer's reserve account is subject to other computations before you can determine what, if any, portion is due the dealer; is that right? (R. 59)

A: Correct. (R. 59)

Q: But the total of all figures that go into this reserve account, you make subsequent computations of taking ten percent of outstanding balances, add to that all the contract accounts over thirty-five days past due and if he has any excess, he has a right to receive that; is that





correct? (R. 64)

A: Right. (R. 65)

Q: Mr. Simpson, you mentioned in your testimony that there was no money represented by these credits to the dealer's finance reserve, for example the \$67.25, that was only a bookkeeping entry on your books. What, if anything must happen before the dealer would ever be entitled to receive any of this money in the dealer's finance reserve? (R. 68).

A: There would have to be some collected balances, money received. (R. 68)

Q: In essence, then Mr. Simpson, this is merely a first allocation of \$67.25, that is merely a bookkeeping record in the bank to determine what ultimately under your contract may be paid to the dealer; is that correct? (R. 69)

A: That is correct. (R. 69)

Thus, in this case there was nothing withheld from the sales price of the paper. This is entirely another transaction, to wit: the bank paid the dealer the cash price which is the market value of the contract at the time that it was assigned. This amount was reported by the dealer and is not an issue. The amount of the unearned interest which the bank agreed to share with the dealer under specific terms and conditions is that which is in issue and constitutes a separate item entirely and is therefore distinguishable from the HANSEN cases. There-



fore, the principal as laid down in the HANSEN case is not applicable to the case before the court. In fact, the Supreme Court specifically and expressly left open the question which is involved in this case. In the HANSEN, et al cases, the Supreme Court stated:

"The taxpayers have argued that portions of the dealers reserve accounts consist of percentages of finance charges, which the finance companies agreed to allow them, and that such percentages of the finance charges not being part of the purchase price of the installment paper should in no event be regarded as accrued income to the dealers".

The Supreme Court in that case stated that since it had no evidence regarding this issue presented by the taxpayers, those taxpayers in the HANSEN case had failed to carry the burden of proof. Thus, this issue was therefore left open by the Supreme Court.

In fact, the issue presented in the instant case is similar to that which was before the court in KEASBEY & MATTISON CO. v U.S. 141 F. 2d 163 (3 CCA 1944).

In the KEASBEY & MATTISON case, the taxpayer sold asbestos products for house improvements to dealers and distributors, who in turn sold to retailers, the retailers then in turn sold to home owners who executed notes for the unpaid balance of the purchase price. When the FHA who had previously guaranteed the financing termin-





ated these guarantees, the taxpayer then arranged with the finance company to accept these notes. The finance company then agreed to discount the notes at the rate of 7%, 5% of which the finance company would retain and the other 2%, the finance company placed in a reserve account. Out of this reserve account would be charged certain losses which the dealer had guaranteed and then the remainder, the finance company would pay to the dealer under the following formula: When the outstanding liabilities were less than 10% of the amount in the reserve 2% discount account, the finance company agreed to pay to the dealer these sums for guaranteeing the contracts. In that case the commissioner accrued as income to the taxpayer those amounts which were set aside in the 2% reserve account and assessed a deficiency against the taxpayer. On appeal from the District Court which held for the commissioner, the Third Circuit of Appeals held that the sums payable; if anything out of the 2% set aside in the reserve account whereby if certain conditions happen, the dealer would be entitled to some sums of money, was not income to be accrued to the dealer when these credits to this account were made; the taxpayers' rights to these credits at that time was not fixed but were contingent upon subsequent events. In fact, the court stated that "whether the plaintiff would ever acquire a fixed





right to receive anything from the reserve fund was contingent and unascertainable throughout the taxable year". The instant case is even more stronger than the KEASBEY & MATTISON case, because there is no doubt in the instant case but that there was a sharing between the bank and the dealer of the finance charges ultimately to be earned. These certainly could not be shared, and were not to be shared by the bank with the dealer until they were earned. As testimony in this case clearly shows, the sharing was consideration for the dealer guaranteeing this paper; that was substantially what happened in the KEASBEY & MATTISON case. Consequently that case as well as the instant case is completely distinguishable from the HANSEN, et al cases. During 1950, the Appellant's right to receive anything from the finance charges or unpaid interest was contingent and unascertainable. Consequently the Tax Court was in error in upholding the commissioner's attempt to accrue as income that portion of the unearned interest which the bank had agreed under a complicated formula to share with the taxpayer as consideration for his guaranteeing the automobile purchaser's liability under the conditional sales contract.

The unearned interest in the instant case had not accrued to either the bank or the dealer until it was earned was explicitly recognized by the bank and its



bookkeeping procedure. At the time the contract was purchased, the bank entered the dealers pro rata share of the unearned charges in its dealer's reserve account. When the contract was cancelled for the reason of a repossession or reason of prepayment of the contract, the bank would then reduce from its unearned discount account that portion of unearned discount applicable to the cancelled portion of the unearned interest. A portion was then reduced from the dealers share of the dealers reserve account and by so making these additions and reductions from the dealers reserve account of this unearned interest, the bank was able to determine what portion if anything, was payable to the dealer which he had a right to receive under the contract with the bank. (R. 5369). A similar method of accounting was used to account for unearned interest in the case of TEXAS TRAILER COACH, INC. COMMISSIONER OF INTERNAL REVENUE, 27 TC 575. The court in speaking of the time of sale and the accruing of interest on the contract states as follows:

"At this time the sale of the trailer had been earned; there is an unconditional right to receive the selling price. The finance or time charge has not been earned, it will be earned over the life of the contract. When the contract is assigned, the finance company rather than the dealer earns and is entitled to the finance charge."

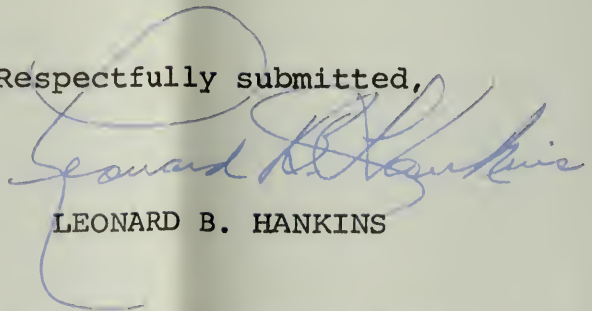




Therefore, since the amount of unearned interest which the bank agreed to share with the dealer when collected from the purchaser of the auto could not be ascertained during the year before this court, there was no income taxable to the dealer. Even considering that it could be ascertained, since it had not been earned, it was not gross income taxable to the dealer during the year in question. The Appellant contends that the Tax Court erred in this regard and that the decision of the court should be reversed by this court determining that taxpayers income should not include any of the unearned interest which the bank agrees to share with the dealer until the dealer has the right to receive some amount which is definitely ascertainable.

WHEREFORE, Appellant respectfully prays that this Court reverse the decision of the Tax Court of the United States.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Leonard B. Hankins", is written over a circular blue ink stamp. The signature is fluid and cursive.

LEONARD B. HANKINS

Attorney for Petitioners.



CERTIFICATE OF SERVICE

It is hereby certified that service of four (4) copies of this brief has been made on opposing counsel by mail in accordance with the rules of the United States Court of Appeals for the Ninth Circuit.

Dated: *November 2*  
October           , 1959.

*Leonard B. Hankins*  
Leonard B. Hankins



In the United States Court of Appeals  
for the Ninth Circuit

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ARTHUR V. MORGAN and DOROTHY O. MORGAN,  
PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

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On Petition for Review of the Decision of the  
Tax Court of the United States

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BRIEF FOR THE RESPONDENT

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FILED

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**In the United States Court of Appeals  
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---

**On Petition for Review of the Decision of the  
Tax Court of the United States**

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**BRIEF FOR THE RESPONDENT**

---

**OPINION BELOW**

The findings of fact and opinion of the Tax Court (R. 19-34) are reported at 29 T.C. 63.

**JURISDICTION**

This case involves deficiencies in federal income tax for 1950 in the amount of \$4,076.40 (R. 35). The taxpayer's <sup>1</sup> income tax return for 1950 was filed with

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<sup>1</sup> For convenience Arthur V. Morgan will be referred to in this brief as the taxpayer, although his wife, Dorothy O. Morgan, is also a petitioner, having filed a joint return with her husband for the taxable year 1950.

the Collector of Internal Revenue for the Sixth District of California. (R. 20.) On December 6, 1954, the Commissioner mailed the taxpayer a notice of deficiency in the amount of \$4,076.40. (R. 8-11.) On March 3, 1955, the taxpayer filed a petition with the Tax Court for a redetermination of the deficiency under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 4-11.) The decision of the Tax Court was entered October 21, 1957. (R. 34-35.) The case is brought to this Court by a petition for review filed January 7, 1958. (R. 4, 35-37.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

### QUESTION PRESENTED

Whether the taxpayer's accrual basis partnership, which sold property on credit and discounted its customers' obligations with a bank, realizing part of its gain in cash and part in the form of amounts which the bank credited to it—the latter portion ultimately to be satisfied either by payment in cash or by offset against the partnership's obligations to the bank—was required to report the amount of gain so credited (as well as the gain in cash) as income for the year in which the sales and credits were made.

### STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and Treasury Regulations involved are printed in the Appendix, *infra*.



## STATEMENT

The facts as stipulated by the parties (R. 14-19), and as found by the Tax Court (R. 20-29), may be summarized as follows:

The taxpayer and Frank D. Lortscher formed a partnership doing business as Art Morgan Motor Company (hereinafter referred to as the partnership) in Long Beach, California, on January 7, 1950. The taxpayer held a 75 per cent interest in that partnership; Lortscher, a 25 per cent interest. The partnership kept its books and returned its income on the accrual method of accounting. The partnership was actively engaged in the purchase and retail sale of used automobiles. A large number of automobiles were sold under conditional sales contracts. In all such sales the conditional sales contracts were simultaneously assigned by the partnership to Farmers & Merchants Bank, Long Beach, California, hereinafter referred to as the bank. (R. 20-21.)

The forms used in the making of conditional sales were furnished by the bank to the partnership. In all of the conditional sales contracts, the purchasers agreed to pay the "Contract Balance" (comprising the several items set forth in the example given below) in equal successive monthly installments at an office of the bank. The contracts provided that title to the cars should remain in the dealer until all payments were made and all conditions of the contract were complied with. Two forms of assignment were used by the partnership in assigning the contracts to the bank. Under one form the assignment was made

“with recourse”; under the other the assignment was made “without recourse.” (R. 21.)

From January 7, 1950, to July 1, 1950, the partnership assigned contracts to the bank under the form which bore the caption “With Recourse” and from July 1950 until the end of the year it assigned contracts under the form designated “Without Recourse.” (R. 21-22.) Both forms of assignment during the year 1950 were made subject to an additional agreement between the partnership and the bank which contained the following provisions (R. 22-23):

4. Evidence of registration showing the Bank as legal owner must accompany all contracts submitted for purchase.

\* \* \* \*

6. Notwithstanding the fact that the said contracts have been and will be assigned to Bank by Dealer without recourse, Dealer promises and agrees to repurchase from Bank contracts, including those executed or assigned on or subsequent to July 1st, 1950 on all such repossessed automobiles by paying Bank therefor the unpaid balance owing on such defaulted contracts, including all sums of principal, interest, charges due and to become due, and any and all collection and repossession costs, less a pro rata rebate of Bank's unearned charges. Dealer hereby waives the provisions of Section 2845, 2849 and 2850 of the Civil Code of the State of California.

\* \* \* \*

10. Bank may retain from the proceeds of each contract purchased hereunder, agreed upon amounts and the accumulated total of said amounts shall be retained by Bank in a Dealer

Reserve Account as security for any and all obligations of Dealer to Bank, now or hereafter existing. Bank agrees, so long as Dealer shall not be in default to Bank and remains solvent and in the automobile business, to return to Dealer every six months, upon request, any amount in said account in excess of 10% of the then aggregate unpaid balances of said contracts, provided that before any releases are made to the Dealer that a 100% reserve is set up for all repossessions, skips and past due accounts which are more than 35 days delinquent. If this agreement be terminated or Dealer discontinues the discounting of contracts, then Bank shall retain all funds in said Reserve Account until all contracts, purchased by Bank from Dealer shall have been paid in full, whereupon, the balance if any, shall then be paid to Dealer.

11. This Agreement may be terminated at any time by either party upon notice in writing to the other, provided, however, that such termination will not impair or effect (*sic*) the liability or obligations of Dealer to Bank under this Agreement on account of any contract purchased or transaction originated prior to the time such notice is given.

The bank did not give any consideration to the fair market value of any contract in purchasing it from the partnership. However, the credit of the purchaser of each automobile was checked by the bank and the sale of each car did not become final until the bank approved the credit. (R. 23.)

The following example is typical, except for the amounts, of the conditional sales contracts entered

into between the partnership and the purchasers of used cars during the year 1950 (R. 24) :

1. Cash Purchase Price	\$2,795.00
2. Sales Tax	83.85
3. Total Cash Purchase Price	2,878.85
4. Less: Downpayment	1,645.85
<hr/>	
5. Unpaid Cash Purchase Price	1,233.00
6. Add: Motor Vehicle Tax	40.00
<hr/>	
7. Unpaid Balance	1,273.00
8. Add: Time Price Differential	143.15
<hr/>	
(Finance Charges or Interest)	
9. Contract Balance	1,416.15

Upon assignment of a contract containing the figures in the example above set out, the bank would immediately pay to the partnership the amount of \$1,233 shown as item 5 and designated "Unpaid Cash Purchase Price." Item 6, the amount of \$40 representing motor vehicle tax, would be paid by the bank either to the partnership or directly to the Department of Motor Vehicles, depending upon whether the partnership or the bank cleared the title to the car. Item 8, designated as "Time Price Differential," consisted of finance charges or interest, and was variable, depending upon what the partnership saw fit to charge the purchaser. At the time of assignment of contracts by the partnership, the bank computed its discount at an agreed percentage of the "Contract Balance" which, in the above example, is \$1,416.15. The rate of discount used in 1950 was 4 per cent per year. In the above example the discount would amount to \$70.90, since the contract was to run for



a period of 15 months. In addition to the discount, the bank made a flat charge of \$5 on each assigned contract. The bank treated the \$5 as earned discount and the \$70.90 as unearned discount. The remainder of the contract balance not paid over in cash to the dealer would be credited to the dealer's reserve account provided for in the above-quoted agreement. In the example, the difference between \$75.90, representing the bank's discount, and the \$143.15, representing the "Time Price Differential"—or \$67.25—represents the amount which would be so credited. (R. 24-25.)

The entries in the dealer's reserve account on the books of the bank were recorded by the partnership in a memorandum account. The partnership did not record such entries in a general ledger account, nor did it reflect them in any of its financial statements. The bank informed the partnership of entries made in the reserve account and periodically sent the partnership statements showing the balance in such account. The bank maintained the dealer's reserve account in order to provide security for the payment of the assigned contracts and to induce the dealer to discount contracts with it. The dealer's purpose in entering into the arrangement with the bank was to secure necessary financing for its operations. (R. 25.)

During the year 1950 some of the purchasers under contracts which the partnership had assigned to the bank paid off the contracts prior to their normal maturity dates and, accordingly, under applicable California law were not obligated to pay the entire sum



designated "Time Price Differential," but only a lesser sum. In these circumstances, the bank debited the reserve account for the portion of the sum that was no longer due from the purchaser. In the above example of a 15-month contract, if the purchaser paid up the contract in 6 months, the bank would reduce the amount of the time price differential by the sum of \$44.20, of which \$22.83 would be entered in its unearned discount account and \$21.37 would be charged to the dealer's reserve account. (R. 25-27.)

The following schedule sets forth, with respect to some of the contracts assigned by the partnership to the bank, the date and amount of the original credits by the bank to the reserve account, and the dates and amounts of the debits to such account in instances of purchasers' prepayments (R. 27) :

Credits to reserve account		Debits to reserve account	
<u>1950</u>	<u>Amount</u>	<u>1950</u>	<u>Amount</u>
January 21	\$ 29.90	February 17	\$ 19.90
March 27	15.40	June 3	2.20
June 1	106.00	June 15	88.32
May 27	49.35	July 20	30.00
June 20	52.24	June 29	52.24
April 14	84.21	August 10	56.01
July 14	50.80	August 16	37.53
August 2	107.57	August 18	94.37
August 4	211.55	August 29	153.40

The above schedule is merely illustrative and does not set forth all instances where prepayments were made by purchasers. (R. 28.)

In determining whether a dealer was entitled to withdraw any amount from the reserve account, the bank deducted from the amount of the reserve the

full amount of the partnership's recourse liability on any delinquent accounts and repossessions. During the year 1950 the credit balance in the reserve account of the Art Morgan Motor Company, reduced on account of delinquencies and repossessions, never exceeded 10 per cent of the aggregate unpaid balances of the contracts that had been assigned by the partnership to the bank. The partnership was not entitled to receive, and the bank was not required to make, and did not make, any payments to the partnership in pursuance of the terms of paragraph 10 of the above quoted agreement. At all times here material, the bank was financially sound and was able to pay any amount due to the partnership. (R. 28.)

During the taxable year the credits to the reserve account totaled \$16,895.08, and the debits thereto totaled \$1,130.76, leaving a credit balance of \$15,764.32 at the end of the year. The partnership did not report as income for the period in question any of the credits to the reserve account or any of the \$15,764.32 credit balance therein; nor did it report any of the debts as a deduction. The partnership did not claim a bad debt deduction for the taxable year in question. (R. 28.)

In determining the deficiency, the Commissioner increased the partnership's income for the taxable year 1950 by the sum of \$15,764.32, representing the credit balance in the reserve account as of the end of the taxable period 1950, and as a consequence increased the taxpayer's distributive share of the income of the partnership. The Commissioner also held that the \$15,764.32 item did not constitute a partnership de-

ductible item under the Internal Revenue Code of 1939. (R. 28-29.)

The Tax Court sustained the Commissioner's determination, holding that the amount of the credit balance in the dealer's reserve account on the books of the bank at the end of the taxable year 1950 constituted gross income to the partnership in that period. (R. 29-34.)

### SUMMARY OF ARGUMENT

All of the amounts withheld by the bank in purchasing conditional sales contracts from the taxpayer's partnership, an accrual-basis automobile dealer, and credited by the bank to a so-called dealer's reserve account in the partnership's name, were includible in the partnership's income in 1950, when withheld and credited. Essentially the same issue presented here has been decided adversely to the taxpayer by the Supreme Court, other Courts of Appeals, and the Tax Court, which have held that dealer reserves belong absolutely to the dealer and that provisions with respect to the payment of the reserves cannot serve to take from income amounts credited which would normally be determinative of his tax liability where a taxpayer is on the accrual basis. The facts here are not distinguishable from the factual situations in the cases decided adversely to the taxpayer.

The portions of the total finance charges which constituted the source of the reserves here in question represented an accrued liability of the bank which the partnership was entitled to receive as a result of the sale of the contracts. As the Supreme Court has in

effect held, they fall into the same category—tax-wise—as reserves of the type which that Court had before it in its recent dealer reserve cases.

The fact that some of the contracts here involved were prepaid, and that the reserve was debited by the bank, proportionately, warrants no change in result here. The charge represented part of the sales price for the commodity sold—just as the cash amount paid would have been regarded if a purchaser had bought the automobile outright, or as the amount paid on a time basis would have been considered if the dealer had retained the retail paper.

Assuming, *arguendo*, that the exact amounts in the reserve accounts which the partnership had a right to receive were in dispute or that eventually it might actually receive only part or even none of the amounts credited, the taxpayer still would be obligated to report the amounts in the reserves as income when the credits were made. There was a presently fixed right eventually to receive those amounts. Once credited to the dealer's reserve, only one of two things could happen: the full amount in the reserve would either subsequently be paid to the dealer in cash or used to discharge the dealer's indebtedness to the finance company. Insofar as the realization of income is concerned, application of the amount in discharge of the dealer's indebtedness is the equivalent of actual payment of such amount to the dealer in cash. It is fundamental that, when the taxpayer's right to an income item becomes fixed, accrual is not to be deferred merely because actual payment is postponed.

After the Supreme Court's decision in the dealers



reserve cases argued before it, an effort was made to have the Court distinguish those cases (allegedly involving only holdback situations) from a case in which, concededly, the exclusive source of the reserve was the finance charge. The Supreme Court, however, denied certiorari in the latter instance.

### ARGUMENT

**The Entire Amounts Withheld By the Bank In Purchasing Conditional Sales Contracts From the Taxpayer's Partnership, An Accrual Basis Automobile Dealer, Which Amounts Were Credited By the Bank To A Reserve Account in the Partnership's Name, Were Includible in the Partnership's Income In 1950 When Withheld and Credited**

The sole issue in this case relates to the failure of the taxpayer's accrual-basis partnership to report as income in 1950 amounts in a reserve account maintained in its name by the bank to which it assigned conditional sales contracts. The taxpayer in his return for that year reported only his distributive share of the income reported by the partnership. In its business of selling used automobiles on the installment plan, the partnership assigned conditional sales contracts to the bank, either with recourse (those sold from January 7, 1950, to July 1, 1950) or without recourse (those sold from July 1950 until the end of the year). The bank paid the partnership the unpaid cash purchase price of the contract, plus the motor vehicle tax which occasionally would be paid direct to the Department of Motor Vehicles, depending on whether the partnership or the bank cleared title to the car. A portion of the finance charges or



interest was credited by the bank to a dealer's reserve account. That portion represented the difference between the bank's discount of 4 per cent and the total finance charges or time price differential. The amount varied, depending upon what the partnership saw fit to charge the purchaser. During 1950 some of the purchasers whose contracts had been assigned satisfied their obligations prior to their normal maturity dates, and accordingly, under applicable California law (Section 2982, California Civil Code, 11 West's Annotated California Codes, R. 26), were obligated to pay less than the entire finance charges. In such circumstances, the bank debited the reserve account for the portion of the finance charges no longer due from the purchaser. The taxpayer here contends (Br. 11-32) that the portion of the finance charges credited to the partnership is not income to him until it is subject to immediate collection.

Essentially the same issue as presented here has been decided adversely to the taxpayer by the Supreme Court in *Commissioner v. Hansen*, 360 U.S. 446 (affirming *Baird v. Commissioner*, 256 F. 2d 918 (C.A. 7th); and reversing *Hansen v. Commissioner*, 258 F. 2d 585 (C.A. 9th), and *Glover v. Commissioner*, 253 F. 2d 735 (C.A. 8th)); *United States v. Hine Pontiac*, 360 U.S. 715 (reversing judgments in three cases entered by the Fifth Circuit on stipulation), petition for rehearing denied, October 12, 1959; *United States v. Colonial Chevrolet Corp.*, 360 U.S. 716 (reversing judgments in two cases entered by the Fourth Circuit on stipulation), petition for rehearing denied, October 12, 1959; see also *Wiley v.*

*Commissioner*, 266 F. 2d 48 (C.A. 6th), certiorari denied, October 12, 1959; *Schaeffer v. Commissioner*, 258 F. 2d 861 (C.A. 6th), certiorari denied, 360 U.S. 917; and *Wood v. Sarwark* (C.A. 9th), decided September 18, 1959. Numerous Tax Court decisions<sup>2</sup> have also uniformly held that dealer reserves belong absolutely to the dealer and that provisions with respect to the payment of the reserves cannot serve to take from income amounts credited which would normally be determinative of his tax liability where a taxpayer is on the accrual basis.

Since this issue has already been presented to and considered by this Court, we shall not burden the Court with further extended argument on the question. We would, however, respectfully ask this Court's reconsideration of its decision in *Hansen* in the light of the Supreme Court's decision in that case and in *Hine Pontiac*. There is no apparent reason for distinguishing the instant appeal on its facts from the cases decided adversely to the taxpayer in the Supreme Court.

The Tax Court properly held (R. 32-33) that the portion of the finance charge which is the source of the reserves here in question was an accrued liability of the bank which the partnership was entitled to receive as a result of the sale of the contracts, it having already been paid in full for the automobile it-

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<sup>2</sup> See *Kilborn v. Commissioner*, 29 T.C. 102, affirmed *sub nom. United States v. Hine Pontiac*, *supra*; *Evans Motor Co. v. Commissioner*, 29 T.C. 555; *Brodsky v. Commissioner*, 27 T.C. 216; *Shoemaker-Nash, Inc. v. Commissioner*, 41 B.T.A. 417; see also Rev. Rul. 57-2, 1957-1 Cum. Bull. 17.

self. The taxpayer errs in the assumptions (Br. 19) that the finance charge had not been earned and that the arrangement between the partnership and the bank was in the nature of a joint venture in which each was to share in the finance charge (time price differential) as it was "earned". The Tax Court rejected the assumptions. (R. 32,33.) In effect, the taxpayer contends (as the taxpayers in part contended in *Hansen*), that to the extent that the credits in the dealer's reserve accounts reflected percentages of finance charges which the bank agreed to allow the partnership, the amounts should in no event be regarded as its accrued income. In *Hansen*, the Supreme Court decided only that the taxpayers had "wholly failed to sustain the burden of showing that *any* part of the amounts credited on the books of the finance companies to the respective Dealers Reserve Accounts was entitled to special treatment." 360 U.S. 446, 469. (Italics supplied.) The Supreme Court did not hold that finance charges were entitled to special treatment; nor would the rationale which the Supreme Court employed in *Hansen* permit such a conclusion. As in *Schaeffer, supra*, the amounts credited to the dealer's reserve account represented an obligation on the part of the purchaser of the automobile to pay finance charges (which were actually prepaid interest to the date of the maturity of the note) in addition to the unpaid balance of the purchase price. But that additional amount was included in the contract executed between the purchaser of the automobile and the partnership, and assigned by the partnership to the bank. Insofar as the taxpayer here

was concerned, the sale of the contracts covering the installment sales of the automobiles was as much a part of the partnership's business as the sale of the automobiles, and there is no reason why the gain from the sale of the contracts (including the portion of the finance charges credited to the reserve account) should not be accrued when the sales occurred. *Shoemaker-Nash, Inc. v. Commissioner*, 41 B.T.A. 417.

The fact that some contracts were prepaid, and the partnership's account was debited by the bank with the portion of the finance charge theretofore credited (R. 27), warrants no change in the result reached below. The prepayment, debiting, and corresponding diminution of the bank's obligation to the partnership must be regarded as a condition subsequent to its liability to pay at the time the sale was made and the credit was entered. Thus, contrary to the taxpayer's argument (Br. 19) no valid distinction can be made between accruing a reserve based on a portion of the finance charge and accruing other portions of the reserve, for the time price differential of the automobile included the finance charge or interest (R. 24). Insofar as the purchaser was concerned, the finance charge or interest (time price differential), which was shown in the contract as payable to the dealer, represented the price of the commodity—just as the cash amount paid would have been so regarded if the purchaser had bought the automobile outright, or just as the amount paid on a time basis would have been considered if the dealer himself had chosen to retain the retail paper, instead of selling it.



As the Sixth Circuit stated in *Schaeffer v. Commissioner*, *supra* (p. 865): "The income \* \* \* accrued \* \* \* before the transfer \* \* \* to the finance company, and such subsequent transfer does not change the legal effect of the prior completed transaction." The Fifth Circuit in *Texas Trailercoach, Inc. v. Commissioner*, 251 F. 2d 395, 397, was constrained to recognize that "When we get down to what actually happens \* \* \* the finance company \* \* \* has a *fixed percentage for its finance charges worked into the sales price.*" (Italics supplied.) The correctness of that view has been recognized in law review articles discussing the origin, development and function of the practice of dealer participation in finance charges. See Hardy, Another View On The Origin of Dealer Participation In Automobile Finance Charges, 30 Ind. L. J. 311 (1955); Note, Is Control Of Dealer Participation A Necessary Adjunct To Regulation Of Installment Sales Financing?, 28 Ind. L. J. 641 (1953); and Pecar, Dealer Participation In Automobile Finance Charges: A Reply, 30 Ind. L. J. 319 (1955). All of these articles assume that the amounts credited to dealers' reserve accounts in arrangements between dealers and finance companies represent, in intention and reality, part of the purchase price for the commodities sold.

The taxpayer mistakenly places reliance (Br. 13-18) on cases, including *North American Oil v. Burnet*, 286 U.S. 417, which in reality support the Commissioner here. Under the claim of right doctrine first enunciated in that case, and reaffirmed in *United States v. Lewis*, 340 U.S. 590, and *Healy v. Commis-*



sioner, 345 U.S. 278, the taxpayer still would be obligated to report the amounts in the reserves as income when the credits were made, even assuming *arguendo* that the exact amounts in the reserve accounts which the partnership had a right to receive were in dispute, or that eventually it might actually receive only part, or even none, of the amounts credited.

Moreover, once an amount was credited to the dealer's reserve here involved, only one of two results followed: it would either subsequently be paid to the dealer in cash or used to discharge the dealer's indebtedness to the finance company. Insofar as the realization of income is concerned, application of the amount in discharge of the dealer's indebtedness is the equivalent of actual payment of such amount to the dealer in cash. See *Clark v. Woodward Construction Co.*, 179 F. 2d 176 (C.A. 10th). And it is of course fundamental that when the taxpayer's right to an income item becomes fixed, accrual is not to be deferred merely because actual payment must be postponed. *Spring City Co. v. Commissioner*, 292 U.S. 182; *Commissioner v. Hansen*, *supra*.

In any event, after the Supreme Court had rendered its decision in the *Hansen* case, *supra*, it denied a petition for a writ of certiorari in *Wiley v. Commissioner*, *supra*, a case in which, concededly, the exclusive source of the reserve was the finance charge, on which ground the taxpayer unsuccessfully sought to distinguish the factual situation in his case from that in the *Hansen* and related cases.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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DECEMBER, 1959.

## APPENDIX

## Internal Revenue Code of 1939:

## SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation or personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*

\* \* \* \*

(26 U.S.C. 1952 ed., Sec. 22.)

## SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but <sup>if</sup> ~~if~~ no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period

or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. \* \* \*

\* \* \* \*

(26 U.S.C. 1952 ed., Sec. 42.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.41-1. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the

taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.



No. 15,898

In the

# United States Court of Appeals

*For the Ninth Circuit*

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ARTHUR V. MORGAN and DOROTHY O. MORGAN,  
*Petitioners,*

VS.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent.*

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On Petition for Review of the Decision of the  
Tax Court of the United States

**Amicus Curiae Brief  
In Support of Petitioners**

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---

On Petition for Review of the Decision of the  
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## **Amicus Curiae Brief In Support of Petitioners**

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### **STATEMENT OF INTEREST**

Our interest in this action is as follows:

Thomas T. Files represents the Petitioners in *Edward C. Cadjew and Vivian L. Cadjew v. Commissioner of Internal Revenue*, pending in this Court (No. 16698), which also involves the dealer reserve issue presented in this action.

Alfred E. Holland and Felix S. Wahrhaftig represent



the Petitioners before the Tax Court of the United States in *Charles E. Brown and Dortha J. Brown* (Docket No. 64959) and *West Coast Trailer Sales* (Docket No. 64960), which also present the dealer reserve issue. These proceedings were set for hearing on the Tax Court calendar commencing October 26, 1959, at San Francisco, California. The Tax Court on October 26, 1959, granted the Petitioners' motions requesting that the proceedings be continued generally, the motions reciting that the final decision in the above-mentioned *Cadjew* case should control and be dispositive of those proceedings.

### **STATEMENT CONCERNING ARGUMENT OF AMICUS CURIAE BRIEF**

We are in accord with the argument set forth in the Brief for the Petitioners and it is not our purpose to reiterate that argument. We shall present additional grounds in support of the Petitioners' contention that income did not accrue at the time credits were made by a bank to a dealer reserve account.

We shall also present, as an alternative to an argument of Petitioners, a middle-ground position as to the extent to which and the time at which the amount of those credits accrued as income. The consideration of this position is respectfully requested in the event the Court does not accept in its entirety the argument in this regard of the Petitioners.

### **SUMMARY OF ARGUMENT**

By virtue of California Civil Code Section 2982(d), the purchaser of a motor vehicle in California under a conditional sale contract does not become unconditionally obligated for the entire amount of the time price differential specified in the contract. That Section authorizes the buyer to satisfy in full the indebtedness evidenced by the contract

at any time before the final maturity thereof through the payment of only a portion of the time price differential. The amount of the time price differential obligation on a satisfaction of the indebtedness before maturity is determined through the application of a formula set forth in the Section and depends upon the number of months the indebtedness would have continued had it not been so satisfied before maturity.

There being no fixed or unconditional obligation on the part of the purchaser of the vehicle to pay the entire amount of the time price differential at the time of the execution of the conditional sale contract, there could not then arise in favor of the seller the fixed or unconditional right to receive that entire amount that is essential to an accrual of income.

The transfer of the conditional sale contract to the bank did not increase the obligation of the purchaser of the vehicle. Similarly, that transfer did not vest in the bank any greater right to the entire amount of the time price differential than was possessed previously by the seller of the vehicle.

In making a credit to the seller's dealer reserve account at the time of the transfer to it of a conditional sale contract, the bank was not unconditionally obligating itself to pay the amount of the credit to the seller either by way of a cash payment or by way of satisfaction of any liability of the seller to the bank. The bank was merely indicating the amount to which the seller would be entitled if the purchaser paid the entire amount of the time price differential rather than the portion thereof which he was obligated to pay on a satisfaction before maturity. In fact, by reason of prepayments by purchasers of vehicles, the bank never became obligated to the seller for the entire amount of the credits to the reserve account.

There being, then, no fixed or unconditional obligation of the bank to the seller for the entire amount of a credit to the seller's dealer reserve account, the entry of the credit at the time of the transfer of a conditional sale contract to the bank did not create in favor of the seller the fixed or unconditional right to that amount that is essential to its accrual as income at that time.

At most, there accrued as income to the seller in 1950 such portion of the amounts credited to the seller's dealer reserve account as was attributable to the amounts of time price differential for which purchasers of vehicles became unconditionally obligated to the bank in 1950.

### **ARGUMENT**

#### **I. The Entire Amount of the Time Price Differential Set Forth in a Conditional Sale Contract for the Sale of a Motor Vehicle in California Does Not Accrue as Income to the Seller When the Contract Is Executed.**

California, in common with other States, has experienced difficulties over the years in the administration of its laws governing the maximum amount of interest and finance charges which may be collected in connection with the sale of goods on the installment method of payment. In an attempt to meet the problem as respects motor vehicles, the California Legislature in 1945 enacted Civil Code Sections 2981 and 2982 (11 West's Annotated California Codes). These Sections provided, among other things, for a so-called time price differential, limited the amount of that time price differential, authorized satisfaction of the indebtedness evidenced by the conditional sale contract at any time before the final maturity thereof, and required the acceptance by the seller of a lesser amount than the amount specified as time price differential in the contract

upon the satisfaction of the indebtedness before maturity.

The portions of these Sections pertinent to this proceeding are subdivisions (c) and (d) of Section 2982, which provided as follows :

“(c) The amount of the time price differential in any conditional sale contract for the sale of a motor vehicle, with or without accessories, shall not exceed 1 percent of the unpaid balance multiplied by the number of months, including any excess fraction thereof as one month, elapsing between the date of such contract and the due date of the last installment, or twenty-five dollars (\$25), whichever is greater, provided that such contract may provide for interest on any delinquent installment from and after the date of delinquency, and for reasonable collection costs and fees in the event of delinquency.”

“(d) Any provision in any conditional sale contract for the sale of a motor vehicle to the contrary notwithstanding, the buyer may satisfy in full the indebtedness evidenced by such contract at any time before the final maturity thereof, and in so satisfying such indebtedness shall receive a refund credit thereon for such anticipation of payments. The amount of such refund shall represent at least as great a proportion of the time price differential, after first deducting from such time price differential a minimum charge of not to exceed twenty-five dollars (\$25), as the sum of the periodic time balances after the month in which such contract is paid in full bears to the sum of all of the periodic time balances under the schedule of payments in the contract, both sums to be determined according to the monthly balances which would result if the indebtedness were paid according to the terms of the contract; provided, however, that the provisions of this subsection shall not impair the right of the seller or his assignee to receive a minimum time price differential of twenty-five dollars (\$25), or to receive inter-

est on delinquent installments or reasonable collection costs and fees, as provided in subsection (c) of this section; and provided further, that where the amount of such refund credit would be less than one dollar (\$1), no refund need be made."

Section 2982 has been held to be merely an extension of the usury laws of the State of California. *Stone v. James*, 142 Cal. App. 2d 738, 740, 299 P.2d 305, 307, citing the exhaustive review of the matter in *Carter v. Seaboard Finance Co.*, 33 Cal. 2d 564, 203 P.2d 758. The obvious purpose of subdivision (d) of the Section is to authorize a purchaser of a motor vehicle to satisfy in full the indebtedness under his conditional sale contract prior to the final maturity thereof and to obligate him on satisfaction prior to maturity to pay only a proportionate part of the time price differential set forth in the contract. Thus, the time price differential is regarded either as interest or as a finance charge inasmuch as the amount thereof which may be collected from the purchaser is made dependent upon the period of time over which the payments extend. The tax Court found that the item in the contract "' \* \* \* designated as 'Time Price Differential' consisted of finance charges or interest \* \* \*" (R. 24).

Subdivision (d) sets forth a formula whereby there may be determined the amount to be paid by a purchaser satisfying his indebtedness before maturity. The provisions of the subdivision constitute, of course, a part of each motor vehicle conditional sale contract. *Bell v. Minor*, 88 Cal. App. 2d 879, 881; 199 P.2d 718, 720; *Castleman v. Scudder*, 81 Cal. App. 2d 737, 740; 185 P.2d 35, 37. The effect of the statutory provision, accordingly, is to write into each motor vehicle conditional sale contract a schedule of the various time price differential payments which would have to be



made by the purchaser upon his satisfaction of the indebtedness at any time during the period over which payments were permitted to be made under the contract.

In the light of Section 2982, a purchaser of a motor vehicle under a conditional sale contract has unconditionally obligated himself to pay as a time price differential not a single stated sum, but rather a series of sums increasing in amount with the passage of the time over which his payments may be made. Inasmuch as the purchaser is not unconditionally obligated to pay the entire amount of the listed time price differential, the seller obviously does not have at the time of the execution of the conditional sale contract a fixed or an unconditional right to receive that entire amount.

The amount of the time price differential did not, accordingly, accrue as income to the seller of the motor vehicle upon the execution of the conditional sale contract. *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182, *Commissioner v. Hansen*, 360 U.S. 446. In fact, the action of the Commissioner recognizes that such is the case for otherwise, inasmuch as he has regarded the sale of a motor vehicle and the transfer of a conditional sale contract to a bank as separate transactions, his determination of a deficiency would have been based on the accrual as income to the seller from the sale of the vehicle of the entire amount of the time price differential and the dealer reserve issue here presented would not have arisen. The theory upon which the Commissioner asserted the deficiency in question is, accordingly, diametrically opposed to the accrual of the amount of the time price difference as income when the conditional sale contract was executed irrespective of whether the time price differential be regarded as interest or a finance charge or as a part of the sales price of the vehicle.

**II. The Bank Did Not, in Making a Credit to the Seller's Dealer Reserve Account on the Transfer to It of a Conditional Sale Contract, Unconditionally Obligate Itself to Pay the Amount of the Credit to the Seller and That Amount Did Not, Therefore, Accrue as Income to the Seller at That Time.**

It is obvious that the transfer of a conditional sale contract to the bank did not in any way increase the obligation of the purchaser of the vehicle under that contract. It is equally obvious that the transfer of the contract did not vest in the bank any greater right to the entire amount of the time price differential than was possessed previously by the seller of the vehicle.

Respondent contends that income accrued to the taxpayer's partnership in the amount credited by the bank to the reserve account of the partnership at the time of the purchase by the bank of a conditional sale contract. The Tax Court unquestionably so held for it stated that "[T]he obligation of the bank to the partnership was an accrued liability at that time." (R. 33). Thus, the Tax Court regarded the bank as having a fixed or unconditional obligation to pay that amount to the partnership, or apply it in satisfaction of the partnership's obligations to it, and the partnership as having a fixed or unconditional right to receive that amount, or have it applied in satisfaction of its obligations to the bank (R. 32, 33).

Yet, the fact remains that the entire amount credited to the partnership's reserve account in 1950 was not ultimately paid to the partnership or applied in satisfaction of its obligations to the bank for the reason that debits were made to that account as a result of prepayments by purchasers of cars (R. 27). The only answer given in the opinion of the Tax Court to this was

"\* \* \* the possibility that subsequent prepayments by purchasers of cars would reduce the amount in the

reserve does not affect the accruability since such reduction would be the consequence of a condition subsequent." (R. 33)

Respondent similarly asserts merely that

"\* \* \* The prepayment, debiting, and corresponding diminution of the bank's obligation to the partnership must be regarded as a condition subsequent to its liability to pay at the time the sale was made and the credit was entered \* \* \*" (Br. 16)

Whether the reductions in the reserve account resulting from prepayments are in fact or in legal contemplation the consequence of a condition subsequent or whether the statements above quoted are merely of the bootstrap-lifting variety is the core of the matter. We see no basis whatever for the introduction of the condition subsequent concept in this situation.

We have shown that the conditional sale contract did not create immediately a fixed or unconditional obligation of the purchaser to pay the entire amount of the time price differential and that the bank upon the transfer of the contract to it did not have a fixed or unconditional right at that time to receive that amount. Under these circumstances and in view of the arrangement under which the reserve account was debited as a result of a payment prior to the maturity date of a contract, it is completely unrealistic to conclude that the bank was assuming a fixed and unconditional obligation to pay to the partnership any portion of an amount which it did not then have a fixed or unconditional right to receive and which in many instances it did not receive.

The Tax Court did not find as a fact, and we know of nothing in the record which would justify a finding, that the bank, under its agreement with the partnership, had a fixed and unconditional obligation to pay to the partnership

(either by way of cash or satisfaction of a partnership liability to the bank) the entire amount of a credit to the dealer reserve account at the time of the entry of the credit.

Strangely enough, the Tax Court used language of condition rather than of fixed obligation and accrual in stating that

“\* \* \* the amount of the reserve in excess of a percentage of the aggregate unpaid contract balances is payable to the partnership and the partnership is entitled to the entire balance in the reserve *if* and when all the contracts are paid in full \* \* \*” (R. 32) (Emphasis added.)

The reference to “when” is understandable; that to “if” is not consistent with the view of accrual, particularly when the purchasers were not unconditionally obligated to pay their respective contracts in full in the sense meant by the Tax Court.

Furthermore, it is completely contradictory from the standpoint of accrual theory to assert, at least in the absence of some very compelling reason, that a fixed or unconditional right to receive an amount is subject to divestment as a consequence of a condition subsequent. That which is subject to a condition is not by its very nature fixed and unconditional from the standpoint of accrual. To apply the condition subsequent concept, as did the Tax Court, is, accordingly, to exalt form above substance in derogation of the basic principle of tax law to the contrary. *Commissioner v. Hansen*, 360 U.S. 446, 461.

The factual situation presented in *Michelin Corporation v. McMahon*, 137 F. Supp. 798, furnishes an apt illustration of the impropriety of the use here of the condition subsequent concept. There, property was sold in December, 1945, for \$700,000, or \$650,000 if the full amount of the purchase price was paid within two years. The purchaser paid \$350,-

000 in cash and gave a secured bond in the sum of \$350,000. The bond, like the contract, permitted prepayment within two years at a discount of \$50,000. In reporting its gain for 1945 from the transaction, the seller computed that gain on a reported \$700,000 gross proceeds from the sale. In August, 1946, the purchaser exercised its privilege of prepayment and paid \$300,000 in full satisfaction of its obligation. In its return for 1946, the seller deducted \$50,000 as a loss to reflect the difference between the \$300,000 received and the \$350,000 face amount of the bond. The suit was instituted to recover the amount of a deficiency assessed by the Commissioner on the basis of the disallowance of this deduction.

To be sure, the question before the Court was the fair market value of the bond at the time of its receipt in 1945 by the seller. The case is of considerable significance for present purposes, however, for two reasons. In the first place, it is clear from the opinion that the Court was of the view that the right of the seller to the \$50,000 was contingent until the two year period had expired. Clearly, the Court would not have distinguished between the accrual of the \$50,000 to an accrual basis taxpayer and the inclusion of that \$50,000 in the fair market value of the bond. In fact, the Court used accrual of income terminology in stating that

*“\* \* \* At no time up to the expiration of the two-year period was the debtor unconditionally obligated to pay the sum of \$350,000. To contend that such a bond and mortgage when received by the plaintiff in 1945 had a value of \$350,000 is to fly in the face of reality and to disregard common experience \* \* \*”* 137 F. Supp. 2d 798, 801. (Emphasis added.)

In the second place, the agreement was phrased in terms of a condition subsequent inasmuch as it provided in the first instance a sales price of \$700,000, which could, however,



be satisfied in full by a payment of \$650,000 within two years. It is submitted that the Court was entirely correct in stating that

“\* \* \* Significant facts which the taxpayer appears to have disregarded are that the sales price was not \$700,000 but either \$700,000 or \$650,000 and that the amount payable under the bond was not \$350,000 but \$300,000 if the purchaser exercised its option. The contract specifically set forth the alternative sales price of \$650,000 \* \* \*” 137 F. Supp. 798, 801.

Assume, for purposes of simplicity in discussion, that the property in question had a zero basis in the hands of an accrual method taxpayer. Further assume that the sales agreement provided that the purchaser would pay \$650,000 for the property, but then went on to provide that if the entire \$650,000 was not paid within two years the purchaser would pay \$700,000 for the property. It is hardly to be doubted that, under these circumstances, Respondent would concede that income of only \$650,000 accrued at the time of the sale. If the \$650,000 were not paid within the two year period, the additional \$50,000 would accrue as income at the end of that period. Unless substance is to be completely subordinated to form, exactly the same result should obtain when the agreement, as in the *Michelin* case, provided for the payment of \$700,000, but for complete satisfaction of the obligation through a payment of \$650,000 within two years. Whether the agreement is expressed in terms of a condition precedent or a condition subsequent should not, accordingly, in this situation control the application of the tax law.

The time price differential involved in the instant case should be regarded in a similar manner. There was no greater obligation cast upon a purchaser of a vehicle from the partnership to pay the entire time price differential set

forth in his contract than was cast upon the purchaser in the *Michelin* case to pay the entire \$700,000 set forth in the agreement there involved. It would necessarily follow that the partnership would not be required to accrue the entire amount of the time price differential as income when the conditional sale contract was executed. In both situations, the factors of passage of time and date of satisfaction of indebtedness would determine the amount of the obligation.

There is no greater reason for introducing a condition subsequent concept with regard to the obligation of the bank to the partnership as to the credits to the dealer reserve account than there is for introducing that concept with regard to the obligation of the purchaser of a vehicle to the partnership and to the bank under the conditional sale contract. Furthermore, the arrangement between the bank and the partnership as respects credits and debits to the dealer reserve account of the partnership in no way requires the conclusion that the vehicle purchaser's satisfaction of his obligation under the conditional sale contract prior to final maturity partakes of the nature of a condition subsequent so as to make the bank's debit to the reserve account in a case of such a satisfaction the consequence of a condition subsequent.

Clearly, the bank and the partnership contemplated that the credit to the reserve account based on the entire amount of the time price differential would constitute a fixed and unconditional obligation of the bank to the partnership only if the entire amount of the time price differential was paid by the purchaser of the vehicle.\* There is no basis in logic

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\*In the event of default by the purchaser of the vehicle, the partnership was obligated to pay to the bank the unpaid balance owing on the defaulted contract, less a pro rata rebate of the bank's unearned charges. (R. 22.) The payment made to the bank by the partnership in such a case was, therefore, the equivalent of a payment prior to maturity by the vehicle purchaser and would result in the same debit to the reserve account as would a payment at that time by the purchaser.

or otherwise, accordingly, for the view that an amount credited to the reserve account thereupon accrued as income and that a debit to the account by virtue of a payment prior to maturity was the consequence of a condition subsequent.

From the standpoint, accordingly, of either the factual situation here involved or the general theory of the accrual of income, there is no basis for asserting that a debit to the reserve account was the consequence of a condition subsequent as a ground for determining that the prior credit to the account created a fixed and unconditional obligation resulting in an accrual of income to the partnership.

The decision of the United States Supreme Court in *Commissioner v. Hansen*, 360 U.S. 446, does not require a determination in this case that the amounts credited to the dealer reserve account accrued as income to the partnership when credited. That decision is based on the consideration that the amount of the credits would either be paid to the dealer in cash or be used to satisfy the dealer's obligations to the bank. Such is not the case here in view of the debits to the account for prepayments (R. 27).

Then, too, the Supreme Court expressly left open the question of the accrual of percentages of "finance charges." 360 U.S. 446, 468. Here, the Tax Court found that the item of the conditional sale contract "\* \* \* designated as 'Time Price Differential' consisted of finance charges or interest \* \* \*" and that the amount of the credit to the reserve account was the difference between the amount of the time price differential and the discount charged by the bank (R. 24, 25).

Even assuming, *arguendo*, that the time price differential is not a finance charge within the meaning of the Supreme Court's reference or that it has not been established herein that the credits to the partnership's dealer reserve account

had been identified as percentages of a finance charge, the *Hansen* decision does not support the Respondent's position. Under this assumption, which is contrary to the findings of the Tax Court, the time price differential would constitute a part of the sales price of a vehicle, but, as shown above, the conditional sale contract did not create a fixed or unconditional obligation on the part of the purchaser of the vehicle to pay that amount irrespective of how it might be characterized and, unless the Tax Court's condition subsequent position be accepted, the entry by the bank of the credit to the partnership's reserve account did not create a fixed or unconditional obligation of the bank to the partnership for the amount of that credit irrespective of its origin.

*Wiley v. Commissioner*, 266 F.2d 48, and *Schaeffer v. Commissioner*, 258 F.2d 861, cited by Respondent (Br. 13, 14) were decided in the Sixth Circuit prior to the decision of the Supreme Court in the *Hansen* case. The *Wiley* case involved a reserve account based on finance charges, but the Court of Appeals merely rested its decision, without discussion, on the *Schaeffer* case. The Tax Court opinion in the *Wiley* case relied upon the condition subsequent approach of the decision here under review. 16 T.C.M. 1089.

The *Schaeffer* case is distinguishable from the instant case in that, as in the *Hansen* case, the amount of the credits to the reserve account would be paid to the dealer or applied to the payment of the dealer's obligations. 258 F.2d 861, 864. Furthermore, the Court there determined that the entire amount of the vehicle purchaser's contract obligation accrued to the dealer (258 F.2d 865), which we have shown not to be the situation under California law.



**III. At Most, There Accrued as Income to the Partnership in 1950 Such Portion of the Amounts Credited to the Partnership's Reserve Account as Was Attributable to the Amounts of Time Price Differential for Which Purchasers of Vehicles Became Unconditionally Obligated to the Bank in 1950.**

It is not our intent to express disagreement with the Petitioners' contention as respects the time of accrual of the amounts credited to the partnership's dealer reserve account. We wish merely to offer an alternative position for consideration in the event the contention of the Petitioners in this regard is not accepted.

We believe that we have established that the entry of a credit by the bank to the partnership's reserve account did not at that time result in an accrual of income to the partnership in the amount of the credit. Admittedly, however, such portion of the amount of those credits as inured to the benefit of the partnership either by way of payments in cash or by way of satisfaction of obligations accrued as income to the partnership at some time.

In the light of the foregoing discussion, it is fundamental that, at most, there accrued as income to the partnership in 1950 such portion of the amounts credited to the partnership's dealer reserve account as was attributable to the amounts of time price differential for which purchasers of vehicles became unconditionally liable to the bank in 1950. By the end of that year the liability of each purchaser of a vehicle for that portion of his contract's time price differential which could no longer be abated under Civil Code Section 2982(d) would have become fixed and unconditional.

Were all the contracts fully satisfied either by virtue of their maturity or their satisfaction in full prior to maturity at the end of 1950, all the debits to the reserve account required as a result of prepayments would have been made and the credit balance in the account could be said to con-



stitute a fixed or unconditional obligation of the bank to the partnership. An amount equal to that balance might similarly be regarded as a fixed or unconditional obligation of the bank to the partnership, inasmuch as it was the portion of the credits to the reserve attributable to the amount of time price differential for which the vehicle purchasers were unconditionally obligated, even though many of the contracts executed in 1950 were not fully satisfied in that year. This does not mean that the partnership would have been entitled to receive a payment from the bank in the amount so regarded as having accrued to it as income in 1950 for that amount would still be held by the bank as security for obligations of the partnership to the bank.

The accrual of income to the partnership from the credits to its dealer reserve account in this manner involves recognition of the principle of the *Hansen* case that an amount accrues as income when the dealer's right to it becomes fixed and it eventually will be paid to him or applied in satisfaction of his obligations and of the basic principle that an amount accrues as income to the partnership only when it has a fixed and unconditional right to receive it.

**CONCLUSION**

Income did not accrue to the taxpayer's partnership in 1950 upon the transfer by the partnership to a bank of conditional sale contracts and the crediting of amounts by the bank to a dealer reserve account of the partnership. At most, income accrued to the partnership in 1950 by reason of the reserve account in a lesser amount than the credit balance of the account at the end of that year.

Respectfully submitted,

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